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IN THE

Supreme Court of the United States

October Term, 1962

No. 874

FAMILY RECORD PLAN, INCORPORATED (Dissolved) and FAMILY RECORD PLAN, INCORPORATED, TRANSFEREE OF FAMILY RECORD PLAN, INCORPORATED (Dissolved),

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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SUBJECT INDEX

PAGE

Citations to opinions below 1

Jurisdiction 2

Questions presented 2

Statutes involved 4

Statement 4

Reasons for granting the writ 7

1. The lower court's decision conflicts in principle with numerous other court decisions in which there has developed a well settled legal rule, commonly referred to as the "Kimbell Diamond doctrine" 7

2. The Ninth Circuit Court of Appeals erroneously relied upon a "stipulation" which was not part of the record of this case 10

3. The lower court erroneously assumed that the burden of proof was on the petitioners as to new matter raised in respondent's answer 12

4. Substantial federal questions which have not been settled by this court are presented by this case 16

   A. The first question which should be resolved is whether the respondent may, under the broad authority vested in him by Congress, arbitrarily change a taxpayer's method of accounting which clearly reflects income, for the sole purpose of taxing a sale or exchange which would otherwise result in non-recognition of gain or loss under the Internal Revenue Code 16

PAGE

B. The second major federal question presented in this case is that, when Congress enacts a specific law, which pronounces that no gain or loss shall be recognized if property is sold or exchanged in the manner and under the circumstances specified therein, may such transactions, nevertheless, be taxable, by applying assignment of income principles to abridge such a non-recognition section..... 19

5. The lower court erroneously decided that the anticipatory assignment of income theory applied to the transaction involved in this case..... 22

Conclusion 27

INDEX TO APPENDICES

Appendix A. Statutory Provisions, Treasury Regulations and Rules of the Tax Court of the United States..... 1

Appendix B:

Petition to Review Decisions of the Tax Court of the United States 31

Upon Petitions to Review Decisions of the Tax Court of the United States..... 36

Opinion of the Tax Court of U. S. Family Record Plan.... 48

Appendix C. Conflicting Opinion 63

Appendix D. Motion of Respondent and Order of the Tax Court of the United States Dated December 20, 1961..... 73

TABLE OF AUTHORITIES CITED

CASES	PAGE
Aitken, George J., 35 T. C. 227	24
Blair v. Commissioner, 300 U. S. 5	19, 23
Briggs, Thomas W., Jr., Par. 56,086, 1956 P-H Memo. T. C.	20
Brown v. Helvering, 291 U. S. 193	18
City Bank of Washington, 38 T. C. No. 72	24
Cold Metal Process Company v. Commissioner, 247 F. 2d 864	20
Commissioner v. Ashland Oil & Refining Co., 99 F. 2d 588, cert. den. 30 U. S. 661	7
Commissioner v. Court Holding Company, 324 U. S. 331	24
Commissioner v. Henry Hess Co., 210 F. 2d 553	16, 20
Commissioner v. Hofheimer's Estate, 149 F. 2d 733	12
Commissioner v. Lester, 366 U. S. 299	27
Commissioner v. Reese, 233 F. 2d 30	24
Cullen, Ruth M., 14 T. C. 368, acq., Cum. Bull. 1950-2 1	8
Dillard, E. S., Par. 61,030, 1961 P-H Memo. T. C.	20
Dillard-Waltermire, Inc. v. Campbell, 255 F. 2d 433	16
Federal Facilities Realty Trust v. Kulp, 227 F. 2d 651	11
Floyd v. Scofield, 193 F. 2d 594	16, 21
Gensinger v. Commissioner, 208 F. 2d 576	16, 20
Georgia Pacific Corporation v. United States, 264 F. 2d 161	8
Hanover Bank v. Commissioner, 369 U. S. 672	27
Harden v. Commissioner, 223 F. 2d 418	15, 18
Harrison v. Schaffner, 312 U. S. 579	19
Helvering v. Cement Investors Inc., 316 U. S. 527	13, 15, 20
Helvering v. Eubank, 311 U. S. 122	19
Helvering v. Gowran, 302 U. S. 238	15
Helvering v. Horst, 311 U. S. 112	19, 21
Helvering v. Taylor, 293 U. S. 507	12, 14, 15
Hovey v. McDonald, 109 U. S. 150	11

PAGE

Hull v. Commissioner, 87 F. 2d 260 12
J. Ungar Inc. v. Commissioner, 244 F. 2d 90 21
James M. Pierce Corp., 38 T. C. No. 64 26
Jordan v. Federal Farm Mortgage Corp., 152 F. 2d 642, cert. den. 328 U. S. 821 11
Jud Plumbing & Heating v. Commissioner, 153 F. 2d 681 ..... 14, 16
Kanawha Gas & Utilities Co. v. Commissioner, 214 F. 2d 685 8
Karagheusian, Miran, Estate of, 23 T. C. 806, rev'd 233 F. 2d 197 12
Keyser v. Farr, 105 U. S. 265 11
Kimbell-Diamond Milling Co., 14 T. C. 74, aff'd 187 F. 2d 718, cert. den. 342 U. S. 827 7
Kniffen, Arthur L., 39 T. C. No. 55 20
Koppers Coal Co., 6 T. C. 1209 7
Kuckenberg, Henry A., 35 T. C. 473, rev'd 309 F. 2d 202 ..... 2, 16, 23, 26
Lehman, Robert, 25 T. C. 629 23
Lucas v. American Code Co., 280 U. S. 445 18
Markle, George B. Jr., 17 T. C. 1593 12
Meagher, Charles F., 20 B. T. A. 68, acq., Cum. Bull. X-247 20
Midland Terminal Ry. v. Warin[illegible] 4 Fed. 185 11
Montana-Dakota Utilities Co. [illegible] 408, acq., Cum. Bull. 1956-2 7 8
Nelson v. Ferguson, 56 F. 2d 121, cert. den. 286 U. S. 565 24
Novo Trading Corp. v. Commissioner, 113 F. 2d 320 ..... 16, 20
Orr Mills, 30 T. C. 150, acq., Cum. Bull. 1958-2 7 8
Parecki v. G. D. Searle & Co., 367 U. S. 303 27
Pearce v. Commissioner, 315 U. S. 543 ..... 19, 23
Poro, James, 39 T. C. No. 62 21
Portland Oil Co. v. Commissioner, 109 F. 2d 479 20
Realty Acceptance Corp. v. Montgomery, 284 U. S. 547 11

PAGE

Roberts Company, 5 T. C. 1, acq., Cum. Bull. 1945 6 20

Roemer v. Simon, 91 U. S. 149 11

Simon J. Murphy Co. v. Commissioner, 231 F. 2d 639 18

Snively, H. B., 19 T. C. 850, acq., Cum. Bull. 1956-2 8, aff'd 219 F. 2d 266 8

Sorin, Arthur, 29 T. C. 959, aff'd 271 F. 2d 741 92

South Lake Farms Inc., 30 T. C. 1027 ..... 16, 17, 21, 23

Spangler, C. D., 32 T. C. 782, aff'd 278 F. 2d 665 12

Standard Paving Co. v. Commissioner, 190 F. 2d 330 ..... 14, 16

Suter, James F., Estate of, 29 T. C. 244, acq., Cum. Bull. 1958-2 8 8

Tauber, Sheldon, 24 T. C. 179, acq., Cum. Bull. 1955-2 9 12

Telephone Directory Advertising Company v. United States, 142 Fed. Supp. 884 ..... 16, 20, 21

Tex-Penn Oil Co. v. Commissioner, 83 F. 2d 518, aff'd 300 U. S. 481 12

Texas Bank and Trust Co., 22 P-H Tax Ct. Memo. Par. 53,185 8

Thomas v. Perkins, 301 U. S. 655 23

Thompson-King-Tate v. United States, 296 F. 2d 290 ..... 15, 18

United Mercantile Agencies, 34 T. C. 808, acq., Cum. Bull. 1961-2 5 ..... 16, 21

United States v. Cumberland Public Service Co., 338 U. S. 451 24

United States v. Frank B. Killian Co., 262 F. 2d 491 11

United States v. Horschel, 205 F. 2d 646 ..... 13, 16, 20

United States v. M. O. J. Corporation, 274 F. 2d 713, acq. Rev. Rule 60-246, Cum. Bull. 1960-2 462 ..... 8, 9, 23

United States v. Mattison, 273 F. 2d 13 8

Weaver, W. H., 32 T. C. 411, rev'd 281 F. 2d 238 12

Weaver, W. H., 25 T. C. 1067 12

PAGE

West Seattle National Bank of Seattle v. Commissioner, 288 F. 2d 47 26

Williamson v. United States, 292 F. 2d 524 20

Wilson, Thomas, 25 T. C. 1058 12

Wimp, Sarah G., Par. 61,342, P-H Memo. T. C. 26

Wood Harmon Corporation v. United States, Par. 9182 U. S. Tax Cas.—CCH, ... F. 2d 21

MISCELLANEOUS

House Report No. 1337, 83d Cong., 2d Sess. (1954) 17, 24, 25, 26

United States Code Congressional & Administrative News, pp. 4240-4241 26

United States Code Congressional & Administrative News, pp. 4244, 4245 ..... 24, 25, 26

United States Code Congressional & Administrative News, pp. 4249, 4251 26

United States Code Congressional and Administrative News, p. 4296 17

RULES AND REGULATIONS

Rules of United States Tax Court, Rule 14 15

Rules of United States Tax Court, Rule 32 ..... 3, 15

Internal Revenue Code, Sec. 337(b) 25, 26

Treasury Regulations, Sec. 1.334-1(c)(4)(vi) 9

Treasury Regulations, Sec. 1.337(a) 25

Treasury Regulations, Sec. 1.337-2(b) 25

Treasury Regulations, Sec. 1.337-(4) 9

Treasury Regulations, Sec. 1.453-9(c) 25

STATUTES

Internal Revenue Code of 1954, Sec. 332 ..... 9, 22

Internal Revenue Code of 1954, Sec. 334(b)(2) 9, 19, 22, 25

Internal Revenue Code of 1954, Sec. 336 ..... 20, 22, 23

PAGE

Internal Revenue Code of 1954, Sec. 337 ..... 13, 17, 19, 20, 21, 24, 25, 26

Internal Revenue Code, Sec. 337(a) 20

Internal Revenue Code of 1954, Sec. 337(c)(2)(B) 9, 23, 25

Internal Revenue Code of 1954, Sec. 351 20

Internal Revenue Code of 1954, Sec. 446(b) 13, 14, 16, 17, 18

United States Code, Title 26, Secs. 312-751 4

United States Code, Title 26, Sec. 312(b)(2)(A)(iii) 27

United States Code, Title 26, Sec. 337 ..... 2, 3, 13

United States Code, Title 26, Sec. 341(b)(3)(C) 27

United States Code, Title 26, Sec. 446(b) 3, 13

United States Code, Title 26, Sec. 735(a)(1) 27

United States Code, Title 26, Sec. 736(b)(2)(A) 27

United States Code, Title 26, Sec. 751(a)(1) 27

United States Code, Title 28, Sec. 1254(1) 2

TEXTBOOKS

13 Cyclopedia of Federal Procedure (3d Ed. 1952, Supp. 1962), Sec. 60.90 11

13 Cyclopedia of Federal Procedure (3d Ed. 1952, Supp. 1962), Sec. 60.91 11

13 Cyclopedia of Federal Procedure (3d Ed. 1952, Supp. 1962), Sec. 62.02 11

13 Cyclopedia of Federal Procedure (3d Ed. 1952, Supp. 1962), Sec. 62.03 11

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on the 22nd day of October, 1962. A rehearing was denied on the 29th day of November, 1962.

Citations to Opinions Below.

The opinion of the Tax Court of the United States [R. 38-53], printed in Appendix B hereto, *infra*, p. 48, is reported in 36 T. C. 305. The opinion of the Circuit Court of Appeals printed in Appendix B hereto, *infra*, p. 31, is reported in 309 F. 2d 208. The opinion of the Circuit Court of Appeals incorporates

by reference the case of *Commissioner v. Kuckenberg, et al.*, printed in Appendix B hereto, *infra*, p. 36, which is reported in 309 F. 2d 202; and a Petition for a Writ of Certiorari is now pending in this Court.

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was entered on October 22, 1962. A copy thereof is appended to this Petition in Appendix B *infra*, p. 31. Rehearing was denied on November 29, 1962. The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

Questions Presented.

1. The facts reveal that the transferee-Petitioner (Family Record Plan, Incorporated, here referred to as transferee) purchased all of the capital stock of the transferor-Petitioner (Family Record Plan, Incorporated (Dissolved), here referred to as transferor *for the purpose of acquiring its assets* and immediately entered into a plan to liquidate transferor. During the liquidation period, which did not exceed twelve months, the transferee caused the transferor to sell its customer contracts for $800,000.00. The portion of the purchase price of the capital stock attributable to the customer contracts was at least $800,000.00. The transferor and transferee were on the cash basis of reporting income [R. 38-43]. The questions presented are:

(a) Whether a new basis of $800,000.00 was attributable to the customer contracts when the transferee purchased the stock of the transferor which would preclude any gain which could be taxed to the transferor when the customer contracts were sold for $800,000.00?

(b) Whether 26 U. S. C. 337 (Appendix A, *infra*, p. 6) precludes the recognition of gain on this transaction.

(c) Whether the Respondent may, under the *general* authority delegated to him by Congress in 26 U. S. C. 446(b), (Appendix A, *infra*, p. 14) arbitrarily change a taxpayer's method of accounting which clearly reflects income, for the sole purpose of taxing a sale which would otherwise result in non-recognition of gain under a *specific* statute, 26 U. S. C. 337 (Appendix A, *infra*, p. 6).

(d) Whether, when Congress enacts a specific law (26 U. S. C. 337) (Appendix A, *infra*, p. 6) that manifests that no gain shall be recognized when property is sold, may the sale, nevertheless, be taxable, by applying assignment of income principles to abridge such a non-recognition section.

(e) Whether the anticipatory assignment of income theory applies to the facts in this case.

2. The Respondent's deficiency notices [R. 11, 21] asserted a deficiency against the petitioners on the theory that the sale of the customer contracts did not qualify for non-recognition under the provisions of 26 U. S. C. 337 (Appendix A, *infra*, p. 6). Rule 32 of the Tax Court of the United States (Appendix A, *infra*, p. 30) clearly states that the burden of proof shall be upon the Respondent in respect of *any* new matter pleaded in his answer. Respondent, in his amended answers [R. 16-17, 28] alleged that the transferor's cash method of accounting did not clearly reflect income and further alleged that only the accrual basis would clearly reflect income. It was later stipulated by the Respondent that he was not challenging the propriety of the transferor's cash method of accounting [R. 38]. The questions presented are:

(a) Whether the burden of proof was upon the Respondent to show that transferor's method of accounting did not clearly reflect income, and if so, did he prove that his re-computation clearly reflected transferor's income.

(b) Whether a court may change the accounting method of a taxpayer when the Respondent has stipulated that he is not challenging it.

3. The court bolstered its opinion with a stipulation [R. 38] which was held by Respondent and not filed by him in the Tax Court of the United States until after the appeal had been perfected (Appendix D, *infra*, p. 73). The questions presented are:

(a) Whether the Tax Court of the United States had jurisdiction to admit a stipulation into evidence which it had not previously seen, for use in the record for the Ninth Circuit Court of Appeals, after the appeal had been perfected.

(b) Whether the Ninth Circuit Court of Appeals was in error when it relied upon such a stipulation.

Statutes Involved.

The pertinent statutory provisions involved are contained in the Internal Revenue Code of 1954, 26 U. S. C. 312-751. Said statutes together with applicable regulations of the Commissioner of Internal Revenue are printed in Appendix A, *infra*, p. 1. Pertinent Rules of the Tax Court of the United States are also printed in Appendix A, *infra*, pp. 29-30.

Statement.

This controversy involves the determination of the income tax liability of the Petitioners, Family Record Plan, Incorporated (dissolved), here referred to as transferor, and Family Record Plan, Incorporated (formerly F. R. P., Inc.), here referred to as transferee, for the September 1, 1954 to February 28, 1955 tax period. Transferee is in the proceeding solely as a transferee; its liability for tax on its own income is not here involved. The facts are not in dispute.

The transferor had, for some years, been in the business of selling a service wherein its customers, for a

stated price, acquired the right (represented by a guarantee certificate and embodied in a written contract), for periods ranging from five to eight years, to have photographs taken by photography studios in the customers' vicinity [R. 85]. The customers also received a photograph album in which to mount the photographs so taken [R. 74]. These albums were ordered by the transferor from an album manufacturer who sent them directly to the customers, after the customer had paid the transferor at least $10.00, the cost of the album to the transferor being less than that amount. The customers were required to pay for the services to be rendered over the five to eight year period, within nine months after the contract was entered into, although such payments frequently extended beyond nine months [R. 87]. The transferor manufactured nothing, never had an inventory, and never at any time held goods for sale to customers [R. 73, 74]. The transferor had written agreements with a large number of studios whereby the studio agreed to take the pictures and supply one copy to the customer without cost to him. Transferor was required to hire territorial representatives to keep in constant contact with the photography studios under contract, and sent these representatives throughout the United States to contract with new photography studios to take a customer's picture if he moved his residence, or the photography studio terminated its contract with the transferor. If the photography studio under contract with the transferor did not perform, or if the customer moved to another community, the transferor was required, pursuant to its contract with the customers, to find another studio which would perform. If there was no available studio, it was required to make a portrait enlargement from a negative furnished by the customer [R. 85, 86, 87; Exs. E, F, G, H, I, J, K, L].

On October 25, 1954, transferee bought all of the capital stock of transferor for $1120,000.00, and transferor then became the wholly owned subsidiary of transferee. The purpose of transferee purchasing the capital stock of transferor was to dissolve transferor, take over its assets, and continue the business [R. 81, 82, 83, 84]. The portion of the purchase price of the capital stock attributable to the customer contracts was at least $800,000.00. The stockholders of transferee had no connection with those of transferor.

On December 10, 1954, the board of directors of transferor adopted a plan of complete liquidation, and transferee, as sole stockholder, consented [R. 41]. The plan required that transferor cease business, which it did (except for the sale as hereafter indicated). The plan contemplated sale of "all or any part of the assets" of transferor. Winding up was to be completed not later than November 30, 1955 [R. 35].

On December 17, 1954, transferor sold its contracts with its customers, by written agreement, to one Smith and wife who were unrelated to transferee or its stockholders. The agreement covered all outstanding contracts, there being 49,000 with an unpaid balance of $1,390,331.91, including 9,000 delinquent accounts in the hands of collection agencies with an unpaid balance of $319,801.77. The sale was without recourse and the Smiths' obligation to pay was unconditional. The purchase price was $800,000.00, payable $200,000.00 down and the balance in installments, with the final payment due not later than September 1, 1955 [R. 36].

By February 28, 1955, transferor was fully wound up and dissolved, and all of its assets, including the contract with the Smiths, were distributed to transferee. The transfer of the Smith contract was made as of December 30, 1954. Of the total purchase price of $800,000.00 agreed to be paid by the Smiths, $225,-

000.00 was paid to transferor, and $575,000.00 was paid, all after January 1, 1955, to transferee [R. 36, 37].

Both transferor and transferee were on the cash basis of accounting. In its final income tax return, transferor did not include any part of the $800,000.00 in its income. The Commissioner included all of it, the Tax Court of the United States sustained the Commissioner, and the United States Court of Appeals for the Ninth Circuit affirmed the Tax Court of the United States.

Reasons for Granting the Writ.

The decision of the court below is contrary to previous settled principles in this field. And unless the numerous conflicts which are present in this case are settled by this Court, the taxpayers of this country will be left in a state of utter confusion and bewilderment.

1. The Lower Court's Decision Conflicts in Principle With Numerous Other Court Decisions in Which There Has Developed a Well Settled Legal Rule, Commonly Referred to as the "Kimbell Diamond Doctrine".

Simply stated, the Kimbell Diamond rule referred to above proclaims that, if stock of a corporation is purchased for the purpose of obtaining the assets of the acquired corporation, the transaction is treated as in substance the acquisition of the assets, even though the objective was accomplished in form by a purchase of stock.[1]

[1] The basic rationale of this rule was first stated in *Commissioner v. Ashland Oil & Refining Co.* (6th Cir., 1938), 99 F. 2d 588, 591, cert. den. (1939) 307 U. S. 661. It was followed in *Koppers Coal Co.* (1946), 6 T. C. 1209, 1219-1222, and somewhat extended in *Kimbell-Diamond Milling Co.* (1950), 14 T. C. 74, 80, aff'd (5th Cir., 1951) 187 F. 2d 718, cert. den. 342 U. S. 827, from which the principle derives its name.

Since then the rule has been frequently applied, sometimes to the advantage of the taxpayer and sometimes to the advantage of

Under the Kimbell Diamond Doctrine no independent significance taxwise attaches to the several steps of the multiple step transaction. The final step of dissolution is viewed not as independent of the stock purchase, but simply as one of the steps in a unitary transaction, the purchase of assets. *Georgia Pacific Corporation v. United States, supra*, note 1.

The facts in the instant case are squarely within the principles just stated. The Tax Court of the United States specifically found that —

> "The purpose of transferee in purchasing the capital stock of transferor was to dissolve transferor and take over its assets." (Appendix B, *infra*, p. 50).

The Court of Appeals in the instant case followed the trial court's findings by stating:

> "Transferee was organized for the purpose of buying the stock of Transferor, liquidating it, and continuing the business." (Appendix B, *infra*, p. 32).

It is apparent that if the legal principle known as the "Kimbell Diamond Doctrine" is applied to this case, the transaction here under consideration must be viewed as a purchase of assets by the transferee; and substance should not thereafter be ignored by giving independent significance taxwise to the fact that the transferor, in

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the Government. See, e.g., *United States v. M. O. J. Corporation* (5th Cir., 1960), 274 F. 2d 713, 717, acq., Rev. Rule 60-246, C. B. 1960-2 462; *United States v. Mattison* (9th Cir., 1959), 273 F. 2d 13, 17-20; *Georgia Pacific Corporation v. United States* (5th Cir., 1959), 264 F. 2d 161, 162-163; *Kanawha Gas & Utilities Co. v. Commissioner* (5th Cir., 1954), 214 F. 2d 685, 691; *Montana-Dakota Utilities Co.* (1955), 25 T. C. 408, 413-415, acq. C. B. 1956-2 7; *H. B. Snively* (1953), 19 T. C. 850, 859-860, acq. C. B. 1956-2, aff'd (5th Cir., 1955), 219 F. 2d 266; *Orr Mills*, (1958), 30 T. C. 150, 153-156, acq. C. B. 1958-2 7; *Estate of James F. Suter* (1957), 29 T. C. 244, 258-260, acq. C. B. 1958-2 8; *Ruth M. Cullen* (1950), 14 T. C. 398, 373, acq. C. B. 1950-2 1; *Texas Bank and Trust Co.* (1953), 22 P-H Tax Ct. Memo, Par. 53,185.

form, sold the contracts. Once it is recognized that the transferee purchased assets and sold assets, the results are manifest. The portion of the cost of the stock attributable to the contracts in question was $800,000.-00 [R. 40, 82] and these contracts were sold for $800,-000.00 [R. 36]. Since no profit was made on the transaction, no tax is owing by these petitioners.[2] In spite of these admitted facts the court below ignored this important legal principle, by holding that the independent step of selling the contracts was fully taxable.

Because the court below overlooked the clear applicability of the "Kimbell Diamond Doctrine" to the facts of this case, its decision is in conflict with principles established by the cases cited in footnote 1 below, and many others. A recent Fifth Circuit Court of Appeals decision with strikingly similar facts squarely conflicts in principle with the instant case. In *United States v. M. O. J. Corporation*[3] (Appendix C, *infra*, p. 63)

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[2]Congress, recognizing that a corporate purchaser who acquires the stock of another corporation in order to acquire the underlying assets, is entitled to the same tax treatment upon a disposition of such assets as is the corporate taxpayer who is able to purchase such assets directly, partially codified the Kimbell Diamond Doctrine. See Int. Rev. Code, §337(c)(2)(B) (Appendix A, *infra*, p. 8) which provides that in a "Kimbell Diamond situation" gain is recognized, even as to sales made during the liquidation period, if property is sold for more than the new basis (viz. the purchase price of the stock) that the property received when the stock of the subsidiary was purchased by the parent. Also see related code sections, Int. Rev. Code §334(b)(2) (Appendix A, *infra*, p. 5) and Int. Rev. Code §332 (Appendix A, *infra*, p. 2).

The codified law thus recognizes that the assets in the hands of a subsidiary corporation receive a new basis, determined according to the relative value that the assets have to the purchase price of the stock, as of the date the stock is purchased. The Respondent's own regulations accepts this concept. Treas. Reg. §1.337-(4) (Appendix A, *infra*, p. 27) and Treas. Reg. §1.334-1(c)(4)(vi) (Appendix A, *infra*, p. 22).

[3](5th Cir., 1961) 274 F. 2d 713, 717, acq.-Rev. Rul. 60-246, C. B. 1960-2 402.

it was held that where a corporation wanted to acquire the assets of an enterprise owned and operated by four corporations, and the acquiring corporation did not want the intervening corporate structures, and did not intend to keep them in existence at the time it acquired them and made them subsidiaries, the liquidation of such subsidiaries was not a liquidation under a section of the Internal Revenue Code dealing with non-recognition of gain or loss. The Court thus concluded that the basis of the property acquired was the amount paid by the acquiring corporation for the stock.

2. The Ninth Circuit of Appeals Erroneously Relied Upon a "Stipulation" Which Was Not Part of the Record of This Case.

Notwithstanding vigorous written and oral objections by counsel for Petitioners, the court below bolstered its decision with a "stipulation" [R. 38] entered into months after the trial of the case was concluded; but which was, unbeknown to Petitioners, held by Respondent and was not filed by him in the Tax Court of the United States until after the appeal in the Ninth Circuit Court of Appeals had been perfected (Appendix D, *infra*, p. 73). The Petition for Review by the Ninth Circuit Court of Appeals was filed on August 15, 1961 and the record was fully designated in August of 1961 [R. 5]. The *ex parte* motion of the Respondent requesting the admission of the stipulation was not filed in or granted by the Tax Court of the United States until December 20, 1961.

A portion of the referred to stipulation was quoted in the opinion of the court below in support of its decision (Appendix B, *infra*, p. 34). The lower court's reliance upon the "stipulation" is in direct conflict with the holdings of other circuit courts of appeal to the effect that the trial court has no jurisdiction to admit new evidence or take other action affecting the

cause in a case after an appeal has been perfected, except to perfect the record or protect the *res* pending review.[4] Moreover, the acceptance of and the reliance on the "stipulation" in the decision below probably conflicts with the applicable decisions of this Court.[5]

If the stipulation had been on file in the Tax Court of the United States at the time the appeal was perfected, then it would have been within the jurisdiction of that court to certify the same to the Court of Appeals in order to perfect the record or protect the *res* pending review. But that is not the situation here.

To "perfect the record" does not and, logically, cannot mean that the trial court may add something to the record that had not been properly introduced before it, and that was not included in any of the proceedings in the case at the time of the filing of the Petition for Review in the Court of Appeals.[6] Certainly, the Tax Court has no power, after the record is filed in the Court of Appeals, to authorize the taking of additional evidence by either of the parties, or to add to the record, matters not before considered by it prior to the filing of the record in the Court of Appeals. If such a procedure could be followed, a clever litigant could hold out a stipulation pending a decision of the case, and if the decision did not suit him, he could file it at any time, even after the case was before this Court.

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[4] *United States v. Frank B. Killian Co.* (6th Cir., 1959), 269 F. 2d 491, 494; *Federal Facilities Realty Trust v. Kulp* (7th Cir., 1955), 227 F. 2d 651, 653-654; *Jordan v. Federal Farm Mortgage Corp.* (8th Cir., 1945), 152 F. 2d 642, 644, cert. den. (1946), 328 U. S. 821; *Midland Terminal Ry. v. Warinner* (8th Cir., 1923), 294 Fed. 185, 189.

[5] *Realty Acceptance Corp. v. Montgomery* (1932), 284 U. S. 547, 550-552; *Hovey v. McDonald* (1883), 109 U. S. 150, 157; *Keyser v. Farr* (1881), 105 U. S. 265; *Roemer v. Simon* (1875), 91 U. S. 149.

[6] See 13 *Cyclopedia of Federal Procedure*, §§60.90, 60.91, 62.02, 62.03 (3d Ed. 1952, Supp. 1962).

3. The Lower Court Erroneously Assumed That the Burden of Proof Was on the Petitioners as to New Matter Raised in Respondent's Answer.

To these Petitioners' knowledge, no court has, prior to the decision below, held that the burden of proof is upon the Petitioner as to new matter set up in the Respondent's answer, when the Respondent has pinpointed the basis of his determination in his deficiency notice. To the contrary, the courts have held that the Commissioner of Internal Revenue has the burden of proving his new contentions under such circumstances.[7] The decision on this point is in direct conflict with the decisions of other courts of appeal.[8]

The matter of who has the burden of proof in Tax Court cases, as to new grounds contained in the Respondent's answer, will remain in dispute until settled by this Court. The question is of vital importance as all litigants should have the right to know when the burden of proof is upon them, in order to make a proper presentation of their cases in the Tax Court of the United States.

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[7] *W. H. Weaver* (1959), 32 T. C. 411, 432, rev'd on other grounds (4th Cir., 1960), 281 F. 2d 238; *W. H. Weaver* (1956), 25 T. C. 1067, 1085; *Estate of Miran Karagheusian* (1955), 23 T. C. 806, 814, rev'd on other grounds (2d Cir., 1956), 233 F. 2d 197; *Sheldon Tauber* (1955), 24 T. C. 179, 185, acq. C. B. 1955-2 9; *George B. Markle, Jr.* (1952), 17 T. C. 1593, 1599; *Cf., Thomas Wilson* (1956), 25 T. C. 1058, 1066, overruled by *C. D. Spangler* (1959), 32 T. C. 782, 793, aff'd (4th Cir., 1960), 278 F. 2d 665, 669-670, where it was held that if the original determination of the Commissioner of Internal Revenue is broad and all encompassing, it includes all new matter later raised. To the same effect see *Arthur Sorin* (1958), 29 T. C. 959, 968-969, aff'd (2d Cir., 1959), 271 F. 2d 741. These latter two cases are distinguishable from the present case, because here the Respondent specifically "earmarked" the basis of his deficiency.

[8] *Commissioner v. Hofheimer's Estate* (2d Cir., 1945), 149 F. 2d 733, 737; *Hull v. Commissioner* (4th Cir., 1937), 87 F. 2d 260, 261; *Cf., Tex-Penn Oil Co. v. Commissioner* (3rd Cir., 1936), 83 F. 2d 518, 524, aff'd (1937), 300 U. S. 481; see *Helvering v. Taylor* (1935), 293 U. S. 507.

The court below based its decision, for the most part, upon the Commissioner's authority under Section 446(b) of the Internal Revenue Code (26 U. S. C. §446(b). (Appendix A, *infra*, p. 14) to disregard the transferor's cash basis of accounting and to require a computation by a method that the Commissioner determined would clearly reflect income. The Commissioner in this case, however, did not allege in his deficiency notices [R. 14, 24] that the transferor's cash method of accounting did not clearly reflect income.[9]

The deficiency notices [R. 11 and 21] pinpointed as the sole reason for the deficiency that the sale of the accounts receivable did not qualify for non-recognition under the provisions of Section 337 of the Internal Revenue Code (26 U. S. C. §337). (Appendix A, *infra*, p. 6). The Respondent raised this new matter, viz., that the transferor's method of accounting did not properly reflect income, in his amended answers [R. 16-17, 28], which he filed on the last day of the trial.

The question of who had the burden of proof is of importance in the instant case because, when the Respondent uses section 446(b) (Appendix A, *infra*, p. 14) to change the cash basis of accounting to the accrual basis, the taxable income which accrued in the particular tax reporting period must be determined. In the instant case, performance of the contracts extended over a five to eight year period [R. 87] requiring a computation of income earned in the period involved, and in later periods. Payments under some of the contracts extended beyond the period involved, and none of the alleged income, held to be taxable herein, had been realized by the transferor from its customers.

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[9]See *United States v. Horschel* (9th Cir., 1953), 205 F. 2d 646, 649-650, where this was fatal to the Commissioner's case. Cf., *Helvering v. Cement Investors, Inc.* (1942), 316 U. S. 527.

Moreover, 9,000 of the contracts sold, representing $319,801.77, were contested by customers and had been turned over to collection agencies [R. 36, 42, 48]. The Respondent made no computations to allocate the alleged income to its proper reporting period under the accrual method, nor did he determine the costs to be later incurred in the performance of these contracts (to ascertain the net earnings from the contracts). He merely arbitrarily accrued the entire sales price of the customer contracts in the period involved.[10]

The question of who had the burden of proof is also of importance because, if the Respondent had the burden of proof he should have made a showing that the taxpayers method of accounting did not clearly reflect income. The Tax Court gave the Commissioner, who Petitioners believe had the burden of proof, ample opportunity to present additional evidence as to the application of section 446(b) (Appendix A, *infra*, p. 14). None was offered; but to the contrary, if the "stipulation" referred to in Point 2 is part of the record, the Respondent stipulated, *after* he raised this

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[10]Compare *Standard Paving Co. v. Commissioner* (10th Cir., 1951), 190 F. 2d 330; *Jud Plumbing & Heating v. Commissioner* (5th Cir., 1946), 153 F. 2d 681. In these cases the Respondent allocated earned and unearned income to the proper reporting periods. Also see *Helvering v. Taylor* (1935), 293 U. S. 507.

In the instant case, out of the $800,000.00 sales price agreed upon when the contracts in issue were sold during liquidation, $575,000.00 was received by the transferee after the transferor had completely dissolved; some of the payments on the contracts were not yet due and [R. 87] services under the contracts were not completed [R. 87, Exs. E, F, G, H]. The court below mistakenly stated (Appendix B, *infra*, p. 32) "the maximum contract period was nine months." The record shows that the contracts extended over a five to eight year period. [R. 85, 87; Exs. E, F, G, H].

new issue in his amended answer, that he was not challenging the propriety of the transferor's cash method of accounting [R. 38].

The court below, while accepting the stipulation as part of the record by citing it in its opinion (Appendix B, *infra*, p. 34), erroneously based its decision on the Commissioner's right to change the method of accounting after the Respondent stipulated he was not challenging the transferor's cash method of accounting. *Cf., Helvering v. Cement Investors Inc.*,[11] The Revenue Act contemplates action by the Commissioner, not the courts.[12]

If these Petitioners have the burden of proof on this issue, they have been misled by a manifestation contained in the Rules of the Tax Court of the United States that "The burden of proof * * * in respect of *any* new matter pleaded in the answer * * * shall be upon the respondent." (Emphasis added.)[13] If these Petitioners had the burden of proof on this issue, they respectfully urge that they should be given the opportunity to establish, before the Tax Court of the United States, additional facts which will affect the result under the new ground contained in Respondents's amended answer, as this theory was followed by the appeals court below, but was not the basis of the Tax Court's decision.[14]

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[11](1942) 316 U. S. 527.

[12]*Harden v. Commissioner* (10th Cir., 1935), 223 F. 2d 418, 421; *cf. Thompson-King-Tate v. United States* (6th Cir., 1961), 296 F. 2d 290, 294, 295.

[13]Rules 14 and 32 of the Tax Court of the United States (Appendix A, *infra*, pp. 29-30).

[14]See *Helvering v. Gowran* (1937), 302 U. S. 238, 246-247; *Helvering v. Taylor* (1935), 293 U. S. 507.

4. Substantial Federal Questions Which Have Not Been Settled by This Court Are Presented by This Case.

A. *The First Question Which Should Be Resolved Is Whether the Respondent May, Under the Broad Authority Vested in Him by Congress,*[15] *Arbitrarily Change a Taxpayer's Method of Accounting Which Clearly Reflects Income, for the Sole Purpose of Taxing a Sale or Exchange Which Would Otherwise Result in Non-Recognition of Gain or Loss Under the Internal Revenue Code.*

The reported cases in this area of our tax law are so contradictory that it is difficult to draw any rational or consistent principle from them.[16] Confusion in this area arises because the courts have failed to distinguish between the reflection of realized income or gain and the recognition of realized income or gain, which is an entirely different concept. Where realized income or gain is correctly reflected under the accounting method

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[15]Int. Rev. Code §446(b) (Appendix A, *infra*, p. 14).

[16]Compare, *Telephone Directory Advertising Company v. United States* (Ct. Cl., 1956), 142 Fed. Supp. 884; *United Mercantile Agencies* (1960), 34 T. C. 808, acq., C. B. 1961-2 5; *Commissioner v. Henry Hess Co.* (9th Cir., 1954), 210 F. 2d 553; *United States v. Horschel* (9th Cir., 1953), 207 F. 2d 646; *Gensinger v. Commissioner* (9th Cir., 1953), 208 F. 2d 576; *Novo Trading Corp. v. Commissioner* (2d Cir., 1940), 113 F. 2d 320; *South Lake Farms Inc.* (1961), 36 T. C. 1027; *Henry A. Kuckenberg* (1960), 35 T. C. 473, rev'd (9th Cir., 1962), 309 F. 2d 202, where the courts refused to accept Respondent's position that the method of accounting of the taxpayers should be changed, with *Jud Plumbing & Heating Co. v. Commisioner* (5th Cir., 1946), 153 F. 2d 681; *Standard Paving Co. v. Commissioner* (10th Cir., 1951), 190 F. 2d 330; *Floyd v. Scofield* (5th Cir., 1952), 193 F. 2d 594; *Dillard-Waltermire, Inc. v. Campbell* (5th Cir., 1958), 255 F. 2d 433, where the Respondent's recomputation of income was upheld.

employed by a taxpayer,[17] and where the income so reflected, nonetheless, results in non-recognition under a specific provision of the law, the Respondent should not be able to change the taxpayer's entire accounting method in order to avoid the impact of such a non-recognition code provision.[18] Sales by taxpayers under section 337 (Appendix A, *infra*, p. 6) may *be reflected* on the liquidating corporation's books, but this does not mean that any gain on the sales should be *recognized*.

The only reason Respondent urged the court below that the transferor's accounting method should be changed from the cash method to the accrual method, was that the customer contracts were sold under a non-recognition section of the code (section 337). (Appendix A, *infra*, p. 6), and not because the transferor's cash method did not clearly reflect income [R. 38]. Congress only gave the Commissioner of Internal Revenue the authority, under section 446(b) (Appendix A, *infra*, p. 14), to change a taxpayer's method of accounting when the method used does not clearly reflect income.[19] The Respondent was,

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[17]The stipulation which may be found at [R. 38] is set forth in full for the convenience of the Court. It reads:

> "*If the cash method of accounting* which was regularly used by the transferor *and the propriety of which has not been challenged herein*, was applied to its sale of accounts receivable on December 17, 1954, it would result in excluding from transferor's income the portion of the selling price ($575,000.00) collected by transferee. This method would not clearly reflect transferor's income, if any, from the sale of accounts receivable. *If it is held that any gain from such sale is recognized* to transferor for federal income tax purposes, the amount of the gain to be included in income for the period September 1, 1954, to February 28, 1955, would be $800,000.00." (Emphasis added.)

[18]*South Lake Farms Inc.* (1961), 36 T. C. 1027, 1035-1040.

[19]See H. R. Rep. No. 1337, 83d Cong., 2d Sess. (1954); U. S. Code Cong. & Ad. News, p. 4296.

therefore, without authority to change the transferor's method of accounting and the court below erred in overlooking this important point.

Even if we assume that it was within Respondent's province to change the transferor's method of accounting to reflect the sale of the customer contracts in this case, he may not create income, where none exists (*cf., Simon J. Murphy Co. v. Commissioner.*)[20] At the time of the accrual all the assets of the transferor had a new basis. The contracts which were sold had a basis of $800,000.00 (see Point 1, *supra*). If the $800,000.00 sale is recognized and the Respondent reflects this sale by then placing the transferor on the accrual basis, *a fortiori* no tax is owing by these Petitioners.

The extent of Respondent's authority under section 446(b) (Appendix A, *infra*, p. 14), should be made known to this country's taxpayers. The decision of the court below stands for the inconceivable proposition that, where our legislative branch has delegated *general* powers to the executive branch, the Respondent may override subsequent *specific* legislation by our Congress (*e.g.*, section 337, (Appendix A, *infra*, p. 6), and may at the same time block any attempt by the judicial branch of our government to correct this untenable situation.[21] Widespread litigation will undoubtedly continue in this field until this Court expresses some definite guide lines clearly stating whether and to what extent the Respondent's authority is unfettered under section 446(b) (Appendix A, *infra*, p. 14).

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[20](6th Cir., 1956), 231 F. 2d 639, 644.

[21]See *Brown v. Helvering* (1934), 291 U. S. 193, 204-205; *Lucas v. American Code Co.* (1930), 280 U. S. 445, 449. *Cf., Harden v. Commissioner* (10th Cir., 1953), 223 F. 2d 418, 421; *Thompson-King-Tate v. United States* (6th Cir., 1961), 296 F. 2d 290, 294, 295.

B. *The Second Major Federal Question Presented in This Case Is That, When Congress Enacts a Specific Law,*[22] *Which Pronounces That No Gain or Loss Shall Be Recognized if Property Is Sold or Exchanged in the Manner and Under the Circumstances Specified Therein, May Such Transactions, Nevertheless, Be Taxable, by Applying Assignment of Income Principles*[23] *to Abridge Such a Non-Recognition Section.*

This question is of importance, not only in the administration of the federal tax laws, but also to taxpayers throughout the country who must rely upon the laws of Congress and the final settlement of disputes concerning these laws by this Court.

It is clearly in the public interest to settle this question, since it is so frequently presented in the organization of and the liquidation of corporations.

The anticipatory assignment of income theory is applicable when a taxpayer makes assignments of income from property, but does not part with a substantial interest in the property, other than the income. In these cases, the transferor is held taxable on the income assigned, by reason of the principle that the power to dispose of income is the equivalent of ownership of it and that the exercise of the power to procure its payment to another, whether to pay a debt or to make a gift, is within the reach of the federal income tax law. *Harrison v. Schaffner*, *supra*, note 23.

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[22]Int. Rev. Code, §337 (Appendix A, *infra*, p. 6), §332 (Appendix A, *infra*, p. 2), §334(b)(2) (Appendix A, *infra*, p. 5).

[23]See *Harrison v. Schaffner* (1941), 312 U. S. 579; *Helvering v. Horst* (1940), 311 U. S. 112; *Helvering v. Eubank* (1940), 311 U. S. 122. *Cf. Peace v. Commissioner* (1942), 315 U. S. 543; *Blair v. Commissioner* (1937), 300 U. S. 5.

Congress has provided special treatment for certain types of transactions by enacting taxing statutes which provide that no gain or loss shall be recognized if the requirements of these statutes are met.[24] In the event that a taxpayer falls within the purview of one of these non-recognition sections, no gain is recognized upon the transaction regardless of the fact that the taxpayer has realized a gain or earned income.

The courts, for no apparent reason, have applied the anticipatory assignment of income theory, as was done in this case (Appendix B, *infra*, pp. 34-35), in order to tax un-realized income to some dissolving corporations,[25] but have consistently held that this theory does not apply when a taxpayer incorporates.[26] Although the courts have more readily applied the anticipatory assignment of income theory to corporate liquidation cases, they have not been consistent in their application of this theory.[27]

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[24]See, *e.g.*, Int. Rev. Code §351, involving incorporation (Appendix A, *infra*, p. 13); §336, involving ordinary liquidations of corporations (Appendix A, *infra*, p. 6); and §337, involving sales during liquidation (Appendix A, *infra*, p. 6).

[25]See, *e.g.*, *Williamson v. United States* (Ct. Cl., 1961), 292 F. 2d 524. *Cf.*, *Helvering v. Cement Investors Inc.* (1942), 316 U. S. 527.

[26]*Arthur L. Kniffen* (Dec. 20, 1962), 39 T. C. No. 55; *Roberts Company* (1945), 5 T. C. 1, acq. C. B. 1945 6; *Charles F. Meagher* (1930), 20 B.T.A. 68, acq. C. B. X-247; *Thomas W. Briggs*, Par. 56,086, 1956 P-H Memo. T. C.; *E. S. Dillard*, Par. 61,030, 1961 P-H Memo. T. C.; *Thomas M. Divine, Jr., et al. v. United States* (U.S.D.C., W.D., Tenn., 1962), ... Fed. Supp. ..... (unreported decision), see 62-2 USTC Par. 9632; also see *Portland Oil Co. v. Commissioner* (1st Cir., 1940), 109 F. 2d 479.

[27]For example, it has been held that a dissolved corporation is not taxable upon corporate transactions which come into fruition after the corporation is dissolved. *Cold Metal Process Company v. Commissioner* (6th Cir., 1957), 247 F. 2d 864, 872-873; *Telephone Directory Advertising Company v. United States* (Ct. Cl., 1956), 142 Fed. Supp. 884; *Novo Trading Corp. v. Commissioner* (2d Cir., 1940), 113 F. 2d 320; *United States v. Horschel* (9th Cir., 1953), 205 F. 2d 646; *Commissioner v. Henry Hess Co.* (9th Cir., 1954), 210 F. 2d 553; *Gensinger v. Commissioner*, (9th Cir., 1953), 208 F. 2d 576; *United Mer-*

The Second Circuit Court of Appeals indicated in *Wood Harmon Corporation v. United States*,[28] a case decided after the instant one, that if a corporate taxpayer has complied with section 337 (Appendix A, *infra*, p. 6), income is not to be attributable to the liquidating corporation under the anticipatory assignment of income theory.[29] This thinking conflicts in principle with the holding of the court below. In the *Wood Harmon* case, since the sale by the corporation took place before the plan of liquidation was adopted, it was the legal and beneficial owner of the assets sold and, therefore, the principles set forth in *Helvering v. Horst*,[30] came into play. If the sale occurs after the plan of liquidation is adopted, and is covered by section 337 (Appendix A, *infra*, p. 6) as in the instant case, the anticipatory assignment of income doctrine is inapplicable, because the liquidating corporation has no control over the source that earns the income.[31]

The reported federal cases on the question of when a taxpayer is taxable on anticipated income have been so numerous and so conflicting, since the earlier pronouncements of this Court, that Petitioners believe a current and more clearly definitive statement of the law on this subject is needed at this time to guide the courts, the taxing authorities and the citizens alike.

Cantile Agencies (1960), 34 T. C. 808, acq. C. B. 1961-2 5; *James Poro* (Jan. 2, 1963), 39 T. C. No. 62; but compare *J. Ungar Inc. v. Commissioner* (2d Cir., 1957), 244 F. 2d 90; *Floyd v. Scofield* (5th Cir., 1952), 193 F. 2d 594.

[28] (2d Cir., Jan. 7, 1963), Par. 9182 U. S. Tax Cas.—CCH ..... F. 2d .....

[29] Also see *South Lake Farms Inc.* (1961), 36 T. C. 1027, where the Tax Court expressly refused to accept the respondent's position that the anticipatory assignment of income theory applied when a wholly owned subsidiary corporation was liquidated into its parent corporation.

[30] (1940), 311 U. S. 112.

[31] *Telephone Directory Advertising Company v. United States* (Ct. Cl., 1956), 142 Fed. Supp. 884.

5. The Lower Court Erroneously Decided That the Anticipatory Assignment of Income Theory Applied to the Transaction Involved in This Case.

The decision of the court below is believed to be erroneous, even if this Court should take the position that the anticipatory assignment of income theory may, in some instances, be applied to factual situations involving corporate liquidations under the general rule contained in section 336 (Appendix A, *infra*, p. 6).

In the instant case, a new entity, the transferee, purchased the stock of the transferor in order to acquire its assets, including its customer contracts and immediately entered into a plan to liquidate transferor (See discussion Point 1 *supra*). When the contracts were sold the transferor had no power of disposition over them, because once the plan of liquidation was adopted all benefit and enjoyment which could be derived from the sale inured to the transferee.[32]

The trial court specifically found that after the purchase of the stock by the transferee, the transferor was not utilized for or availed of by the transferee to produce any property with a view to the realization by itself of any gain other than dividends (Appendix B, *infra*, p. 52).[33] Consequently, the avoidance of taxes by the transferor and the enjoyment derived from passing one's income on to another is completely lacking here.[34]

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[32] *Id.*

[33] If the stipulation referred to in Point 2, *supra*, is deemed part of the record, the Respondent has conceded this point [R. 38].

[34] If the transferor (subsidiary) had fully liquidated into its transferee (parent) prior to the sale, no tax would be owing either at the date the contracts were distributed in dissolution or when the contracts were later sold, unless, of course, the contracts were sold for more than their new basis. Int. Rev. Code §332 (Appendix A, *infra*, p. 2), and Int. Rev. Code §334-

The contracts were sold without recourse, for a fixed price to an unrelated third party. The transaction in issue here represented an outright sale of all proprietory rights in the contracts, under a non-recognition provision of the Internal Revenue Code, section 337(c)(2)(B) (Appendix A, *infra*, p. 8).[35] The contracts (the corpus) and all rights under them were sold to the Smiths and they as the owners of these contracts, were the owners of the income these contracts produced, after the sale.

Although this Court has previously distinguished the cases relied upon by the court below by holding that when the corpus has been parted with, the tax liability attaches to the person who owns the corpus,[36] the Ninth Circuit Court of Appeals failed to distinguish this type of case from those in which the mere right to income has been assigned.

(b)(2) (Appendix A, *infra*, p. 5), and Int. Rev. Code §336 (Appendix A, *infra*, p. 6); *South Lake Farms Inc.* (1961), 36 T. C. 1027; and *United States v. M. O. F. Corporation* (5th Cir., 1960), 274 F. 2d 713, acq., Rev. Rul. 60-246, C. B. 1960-2 462.

[35]The court below relied upon the reasons stated in *Commissioner v. Kuckenberg* (9th Cir., 1962), 309 F. 2d 202 (Appendix B, *infra*, p. 30), for its holding in the instant case. (A petition for a Writ of Certiorari is now pending in this court.) There are many differences between that case and the instant case. In *Kuckenberg*, the purchaser of its contracts was given a warranty that he would recover his purchase price in full and he was further indemnified from any further liability; the Kuckenberg contracts were completed; there was an attempt made by the same stockholders who had previously been conducting the business under corporate form to transform ordinary income to capital gain by the device of a sale during liquidation; and the Commissioner in his deficiency notice alleged that Kuckenberg's cash method of accounting did not clearly reflect income. None of these facts exist in this case.

[36]*Pearce v. Commissioner* (1942), 315 U. S. 543; *Blair v. Commissioner* (1937), 300 U. S. 5; *cf.*, *Thomas v. Perkins* (1937), 301 U. S. 655.

In a case similar to the present one, the First Circuit Court of Appeals in *Commissioner v. Reese*[37] observed:

> "And where, as in this case, we are not squarely controlled by a ruling of the Supreme Court, *we think we ought to get back to the provision of the Internal Revenue Code itself* to see whether arguments advanced by the Commissioner to demonstrate the continued taxability of an assignor *comport with the statutory scheme.*" (Emphasis added.)[38]

Looking to the statutory scheme here involved, we find that Congress intended, by the enactment of the 1954 code provisions concerning corporate liquidations, to provide definitive rules that would eliminate uncertainties in the law which were traps for the unwary.[39]

Prior to the enactment of the 1954 Internal Revenue Code, uncertainties arose as to whether, in fact, a sale of assets had been effected by the corporation or by the shareholders. This problem was raised in many court decisions, including *Commissioner v. Court Holding Company*[40] and *United States v. Cumberland Public Service Co.*[41]

In section 337 (Appendix A, *infra*, p. 6), Congress attempted to eliminate the difference in tax result between a sale by the corporation followed by liquidation and a liquidation of the corporation followed

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[37](1st Cir., 1956), 233 F. 2d 30, 33.

[38]Also see *Nelson v. Ferguson* (3rd Cir., 1932), 56 F. 2d 121, cert. den., 286 U. S. 565; *George J. Aitken* (1960), 35 T. C. 227; *Robert Lehman* (1955), 25 T. C. 629.

[39]H. R. Rep. No. 1337, 83d Cong., 2d Sess. (1954), U. S. Code Cong. & Ad. News, pp. 4244, 4245. Also see, *City Bank of Washington* (Aug. 23, 1962), 38 T. C. No. 72.

[40](1945) 324 U. S. 331.

[41](1950) 338 U. S. 451.

by a sale, by placing the tax impact solely upon the shareholders, and not upon the liquidating corporation.[42] Congress further adopted the "Kimbell-Diamond Doctrine" mentioned in Point 1, *supra*, in an attempt to clarify this area of the tax law.[43] The transferee in this case, who was not related to the transferor [R. 41, 42], relied upon specific federal statutes, when it purchased the stock of transferor in order to acquire its assets. These same statutes were relied upon when some of the assets were sold to an unrelated third party during the transferor's liquidation.

The Respondent's regulations do not contain the slightest hint that the sale of contracts by a cash basis corporation, under the statute in issue, would not be accorded non-recognition treatment by him, by reason of the "anticipatory assignment of income theory", or any other provision of the taxing statutes.[44] A persuasive example that the Petitioners were entitled to rely upon section 337 (Appendix A, *infra*, p. 6) is contained in other regulations of the Respondent which have long conceded that where the Internal Revenue Code provides exceptions to recognition of gain or loss, income will not be anticipated and taxable when installment obligations are disposed of under a non-recognition code section.[45]

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[42] H. R. Rep. No. 1337, 83d Cong., 2d Sess. (1954), U. S. Code Cong. & Ad. News, pp. 4214, 4245.

[43] See Int. Rev. Code §334(b)(2) (Appendix A, *infra*, p. 5) and its companion provisions, Int. Rev. Code §337-(c)(2)(B) (Appendix A, *infra*, p. 8).

[44] Treas. Reg. 1.337-2(b) (Appendix A, *infra*, p. 26); Treas. Reg. §1.337(a) (Appendix A, *infra*, p. 26) states:

> "With the exceptions listed above the term property includes all assets owned by a corporation."

The list of exceptions referred to in the Regulations are those provided in Int. Rev. Code §337(b) (Appendix A, *infra*, p. 7). The contracts here involved are not within the listed exceptions contained in the code.

[45] Treas. Reg. §1.453-9(c) (Appendix A, *infra*, p. 28).

These petitioning taxpayers are asked to pay a large amount in taxes because they entered into the transaction in issue, instead of being accorded the non-recognition treatment carefully spelled out by an informed Congress;[46] but the decision in this case will not only affect these Petitioners. If it is allowed to stand, it is certain to result in a clear miscarriage of justice for many other taxpayers who have quite properly relied upon the statutes enacted by Congress, concerning corporate liquidations.[47] Specifically, the intended meaning and scope and proper application of section 337 (Appendix A, *infra*, p. 6) requires clarification. A multitude of transactions by many taxpayers in all parts of the country, both in the past and continuing into the future will be affected by the interpretation of this relatively new tax section of the Internal Revenue Code. This section was enacted in order to provide clarity, not to increase confusion in this field.

The statute in issue here, in plain language, requires non-recognition of gain or loss when property (including inventory sold in bulk and other assets which are normally accorded ordinary income treatment) is sold.[48]

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[46]H. R. Rep. No. 1337, 83d Cong., 2d Sess. (1954), U. S. Code Cong. & Ad. News, pp. 4240-4241, 4244-4245, 4249, 4251.

[47]See *e.g., Commissioner v. Kuckenberg* (9th Cir., 1962), 309 F. 2d 202, rev'g 35 T. C. 473; *Sarah G. Wimp* (1961), P-H Memo. T. C. ¶61,342; *cf. West Seattle National Bank of Seattle v. Commissioner* (9th Cir., 1961), 288 F. 2d 47; *James M. Pierce Corp.* (Aug. 15, 1962), 38 T. C. No. 64.

[48]Int. Rev. Code §337(a) provides that if a corporation adopts a plan to completely liquidate within a 12-month period no gain or loss is recognized to the corporation from the sale or exchange by it of property within the 12-month period.

Int. Rev. Code §337(b) excludes from the term property: (1) inventory type assets, and (2) installment obligations derived from the sales of inventory, prior to the time the plan of liquidation was adopted. Accounts receivable and unrealized receivables were not excluded, only the limited term "installment obligations" was excepted. [See, other sections of the code which exclude

The Respondent demands, however, that the sale under consideration here should be recognized. Under similar circumstances, when the Respondent has urged this Court to do what the legislative branch of the Government failed or elected not to do, this Court has taken the firm position that it is not within its province to alter the statute to effect a purpose which does not appear on its face.[49]

Because of the divergent opinions expressed by the federal courts of our land on this subject, the views of this Court are urgently needed to stop the endless litigation which will continue to ensue.

Conclusion.

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

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"unrealized receivables" from favored treatment (26 U. S. C. §§312(b)(2)(A)(iii) (Appendix A, *infra*, p. 1), 341(b)(3)(C) (Appendix A, *infra*, p. 11), 735(a)(1) (Appendix A, *infra*, p. 15), 736(b)(2)(A) (Appendix A, *infra*, p. 15), and 751-751(a)(1) (Appendix A, *infra*, p. 15).] Inventory was excluded since if it was not, a corporation could carry on normal business operations during the 12-month liquidation period without tax consequences. But, even inventory which is sold in bulk, and installment obligations derived from such a sale during the liquidation period are within the definition of property, as such transactions are part of the winding up process of liquidation.

[49] *Hanover Bank v. Commissioner* (1962), 369 U. S. 672, 682, 687, footnote 23, p. 688; *Commissioner v. Lester* (1961), 366 U. S. 299, 304-307. *Cf., Jarecki v. G. D. Searle & Co.* (1961), 367 U. S. 303, 307-308.

APPENDIX A.

The Internal Revenue Code of 1954, 26 U. S. C. 312 *et seq.*, provides in pertinent part as follows:

INTERNAL REVENUE CODE

"Sec. 312. Effect on Earnings and Profits.

* * * * *

"(b) Certain Inventory Assets.—

* * * * *

(2) Definitions.

(A) Inventory Assets.—For purposes of paragraph (1), the term 'inventory assets' means—

(i) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(ii) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business; and

(iii) unrealized receivables or fees, except receivables from sales or exchanges of assets other than assets described in this subparagraph.

(B) Unrealized Receivables or Fees.—For purposes of subparagraph (A)(iii), the term 'unrealized receivables or fees' means, to the extent not previously includible in income under the method of accounting used by the corporation, any rights (contractual or otherwise) to payment for—

(i) goods delivered, or to be delivered, to the extent that the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(ii) services rendered or to be rendered."

"Sec. 332. Complete Liquidation of Subsidiaries.

"(a) General Rule.—No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

"(b) Liquidations to Which Section Applies.—For purposes of subsection (a), distribution shall be considered to be in complete liquidation only if—

(1) The corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (excepting nonvoting stock which is limited and preferred as to dividends); and either

(2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(3) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock, in ac-

cordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary or his delegate may require of the taxpayer such bond, or waiver of the statute of limitations or assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete can-

cellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

"Sec. 334. Basis of Property Received in Liquidations.

"(a) General Rule.—If property is received in a distribution in partial or complete liquidation (other than a distribution to which section 333 applies), and if gain or loss is recognized on receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution.

"(b) Liquidation of Subsidiary.—

(1) In General.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), then except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor. If property is received by a corporation in a transfer to which section 332(c) applies, and if paragraph (2) of this subsection does not apply, then the basis of the property in the hands of the transferee shall be the same as it would be in the hands of the transferor.

(2) Exception.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), and if—

(A) the distribution is pursuant to a plan of liquidation adopted—

(i) on or after June 22, 1954, and

(ii) not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as denied in paragraph (3)) during a period of not more than 12 months,

then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary or his delegate, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

(3) Purchase Defined.—For purposes of paragraph (2) (B), the term 'purchase' means any acquisition of stock, but only if—

(A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (ii) under section 1014(a) (relating to property acquired from a decedent),

(B) the stock is not acquired in an exchange to which section 351 applies, and

(C) the stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock.

(4) Distributee Defined.—For purposes of this subsection, the term 'distributee' means only the corporation which meets the 80 percent stock ownership requirements specified in section 332(b)."

"Sec. 336. General Rule.

"Except as provided in section 453(d) (relating to disposition of installment obligations), no gain or loss shall be recognized to a corporation on the distribution of property in partial or complete liquidation."

"Sec. 337. Gain or Loss on Sales or Exchanges in Connection With Certain Liquidations.

"(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

"(b) Property Defined.—

(1) In general.—For purposes of subsection (a), the term 'property' does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business.

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with Respect to Inventory in Certain Cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the prop-

erty described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term 'property' includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

"(c) Limitations.—

(1) Collapsible Corporations and Liquidations to Which Section 333 Applies.—This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341(b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidation to Which Section 332 Applies.—In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), this section shall apply only to that portion (if any) of the

gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b)(2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquating corporation, of the property sold or exchanged."

"Sec. 341. Collapsible Corporations.

"(a) Treatment of Gain to Shareholders.—Gain from—

(1) the sale or exchange of stock of a collapsible corporation,

(2) a distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) a distribution made by a collapsible corporation which, under section 301(c)(3)(A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property, to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as provided in subsection (d), be considered as gain from the sale or exchange of property which is not a capital asset.

"(b) Definitions—

(1) Collapsible Corporations.—For purposes of this section, the term 'collapsible corporation' means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to—

(A) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise) or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) the realization by such shareholders of gain attributable to such property.

(2) Production or Purchase of Property.—For purposes of paragraph (1), a corporation shall be deemed to have manufactured, constructed, produced, or purchased property, if—

(A) it engaged in the manufacture, construction, or production of such property to any extent,

(B) it holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

(C) it holds property having a basis determined, in whole or in part, by reference to the cost of

property manufactured, constructed, produced, or purchased by the corporation.

(3) Section 341 Assets.—For purposes of this section, the term 'section 341 assets' means property held for a period of less than 3 years which is—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(B) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business;

(C) unrealized receivables or fees, except receivables from sales of property other than property described in this paragraph; or

(D) property described in section 1231(b) (without regard to any holding period therein provided), except such property which is or has been used in connection with the manufacture, construction, production, or sale of property described in subparagraph (A) or (B).

In determining whether the 3-year holding period specified in this paragraph has been satisfied, section 1223 shall apply, but no such period shall be deemed to begin before the completion of the manufacture, construction, production, or purchase.

(4) Unrealized Receivables.—For purposes of paragraph (3)(C), the term 'unrealized receivables or fees' means, to the extent not previously includible in income under the method of accounting used

by the corporation, any rights (contractual or otherwise) to payment for—

(A) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(B) services rendered or to be rendered.

"(c) Presumption in Certain Cases.—

(1) In General.—For purposes of this section, a corporation shall, unless shown to the contrary, be deemed to be a collapsible corporation if (at the time of the sale or exchange, or the distribution, described in subsection (a)) the fair market value of its section 341 assets (as defined in subsection (b)(3)) is—

(A) 50 percent or more of the fair market value of its total assets, and

(B) 120 percent or more of the adjusted basis of such section 341 assest.

Absence of the conditions described in subparagraphs (A) and (B) shall not give rise to a presumption that the corporation was not a collapsible corporation.

(2) Determination of Total Assets.—In determining the fair market value of the total assets of a corporation for purposes of paragraph (1)-(A), there shall not be taken into account—

(A) cash,

(B) obligations which are capital assets in the hands of the corporation (and governmental obligations described in section 1221(5)), and

(C) stock in any other corporation."

"Sec. 351. Transfer to Corporation Controlled by Transferor.

(a) General Rule.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) Receipt of Property.—If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then—

(1) gain (if any) to such recipient shall be recognized, but not in excess of—

(A) the amount of money received, plus

(B) The fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

(c) Special Rule.—In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

(d) Cross References.—

(1) For special rule where another party to the exchange assumes a liability, or acquires property subject to a liability, see section 357.

(2) For the basis of stock, securities, or property received in an exchange to which this section applies, see sections 358 and 362.

(3) For special rule in the case of an exchange described in this section but which results in a gift, see section 3501 and following.

(4) For special rule in the case of an exchange described in this section but which has the effect of the payment of compensation by the corporation or by a transferor, see section 61(a)(1).

"Sec. 446. General Rule for Methods of Accounting.

"(a) General Rule.—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books."

"(b) Exceptions.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income."

"(c) Permissible Methods.—Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting—

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary or his delegate."

"Sec. 735. Character of Gain or Loss on Disposition of Distributed Property.

"(a) Sale or Exchange of Certain Distributed Property.—

(1) Unrealized Receivables.—Gain or loss on the disposition by a distributee partner of unrealized receivables (as defined in section 751(c)) distributed by a partnership, shall be considered gain or loss from the sale or exchange of property other than a capital asset."

"Sec. 736. Payments to a Retiring Partner or a Deceased Partner's Successor in Interest.

* * * * * *

"(b) Payments for Interest in Partnership.—

* * * * * *

(2) Special Rules.—For purposes of this subsection, payments in exchange for an interest in partnership property shall not include amounts paid for—

(A) unrealized receivables of the partnership (as defined in section 751(c)), * * *"

"Sec. 751. Unrealized Receivables and Inventory Items.

[Sec. 751(a)]

"(a) Sale or Exchange of Interest in Partnership—The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

(1) unrealized receivables of the partnership; or

(2) inventory items of the partnership which have appreciated substanially in value, shall be

considered as an amount-realized from the sale or exchange of property other than a capital asset."

* * * * * *

"[Sec. 751(c)]

"(c) Unrealized Receivables.— For purposes of this subchapter, the term 'unrealized receivables' includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

(1) goods, delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(2) services rendered, or to be rendered.

"[Sec. 751(d)]

"(d) Inventory Items Which Have Appreciated Substantially in Value—

(1) Substantial Appreciation.—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds—

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory Items.—For purposes of this subchapter the term 'inventory items' means—

(A) property of the partnership of the kind described in section 1221(1),

(B) any other property of the partnership which, on sale or exchange by the partnership,

would be considered property other than a capital asset and other than property described in section 1231, and

(C) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in subparagraph (A) or (B)."

APPLICABLE REGULATIONS

§1.334-1. Basis of property received in liquidations. —(a) *In general.* Section 334 sets forth rules prescribing the basis of property received in a distribution in partial or complete liquidation of a corporation. The general rule of section 334 is set forth in section 334(a), to the effect that if property is received in a distribution in partial or complete liquidation and if gain or loss is recognized on the receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution. Such general rule has no application to a liquidation to which section 332 or section 333 applies. See section 334(b) and (c).

(b) *Transferor's basis.* Unless section 334(b)(2) and subsection (c) of this section apply, property received by a parent corporation in a complete liquidation to which section 332 is applicable shall, under section 334(b)(1), have the same basis in the hands of the parent as its adjusted basis in the hands of the subsidiary. The rule stated above is applicable even though the subsidiary was indebted to the parent on the date the plan of liquidation was adopted and part of such property was received in satisfaction of such indebtedness in a transfer to which section 332(c) is applicable.

(c) "*Application of stock basis to property.* If section 334(b)(2) applies to a complete liquidation to which section 332 is applicable, then property received by a parent corporation in such complete liquidation shall have a basis determined by reference to the basis of the stock of the subsidiary corporation with respect to which it is received. In general, section 334(b)(2) will be applicable to a distribution in complete liquidation of a subsidiary corporation if the parent corporation purchased, within the meaning of section 334(b)(3) and during a period of not more than twelve months, 80 percent or more of the stock (other than nonvoting stock which is limited and preferred as to dividends) of the subsidiary corporation and then adopted a plan of liquidation (on or after June 22, 1954) not more than two years after the date on which the stock ownership requirement was met. The application of section 334(b)(2) is subject to the following rules:

"(1) Property received with reference to stock owned immediately before the liquidation by the parent corporation is the only property to which section 334(b)(2) is applicable. The section is not applicable to property received with respect to debt or other claims. The basis of the stock used in determining the basis of the assets is the total basis of all stock held by the parent corporation whether or not such stock was acquired by purchase and whether or not such stock is the stock acquired during the period to which reference is made in section 334(b)(2)(A).

"(2) The date of adoption of a plan of liquidation is determined under section 332(b)(2).

"(3)(i) Except as provided in subdivision (ii) of this subparagraph, in the case of a series of purchases of stock, the two-year period specified in section 334-(b)(2)(A) shall begin on the day following the earliest date which is the end of a period of twelve months or less within which the amount of stock required by section 334(b)(2)(B) was acquired. For example, assume that 20 percent of the stock of Corporation A is purchased on each of the following dates: April 1, 1956, June 30, 1956, September 30, 1956, December 31, 1956, and June 1, 1957. The two-year period shall begin on January 1, 1957. However, if the first purchase of 20 percent of the stock occurs on November 1, 1955 (instead of April 1, 1956), then the two-year period shall begin on June 2, 1957.

"(ii) If a plan of liquidation is adopted on or before December 24, 1958, subdivision (i) of this subparagraph shall not apply and the rule of subdivision (iii) of this subparagraph shall apply unless the parent corporation elects to have the rule of subdivision (i) of this subparagraph apply. Such election shall be made by the parent corporation either in a statement attached to its return (filed within the time prescribed for filing, including any extensions of time) for the taxable year within which such plan is adopted or in a statement filed on or before September 22, 1958, with the district director with whom such corporation return for such taxable year was filed. The election, once made, shall be revocable.

"(iii) The rule referred to in subdivision (ii) of this subparagraph is as follows:

"(a) In the case of a series of purchases of stock, the two-year period specified in section 334(b)(2)(A) shall

begin on the day following the date of the last such purchase if the amount of stock specified in section 334(b)-(2)(B) is purchased during the preceding twelve months.

"(b) Application of the rule prescribed in (a) of this subdivision may be illustrated by the following example:

"*Example.* Twenty percent of the stock of Corporation A is purchased on each of the following dates: April 1, 1954, June 30, 1954, September 30, 1954, December 31, 1954, and April 1, 1955. Although 80 percent of the stock of Corporation A had been purchased as of December 31, 1954, the date of the last transaction of the series of transactions described in section 334(b)-(2)(B) is April 1, 1955, and therefore the two-year period shall begin on April 2, 1955.

"(4) For the purpose of section 334(b)(2) only, the following adjustments shall be made to the adjusted basis of the subsidiary's stock in the hands of the parent:

"(i) Such adjusted basis shall be reduced by the amount of all distributions received by the parent from the subsidiary during the period beginning on the day on which the stock used in determining the applicability of section 334(b)(2) was purchased (or if such stock was purchased on more than one day, on the day of the earliest purchase of the stock so used) and ending when the plan of liquidation is adopted.

"(ii) In order to apply the rule of subdivision (i) of this subparagraph the amount of a distribution in kind shall be whichever of the following is the greater:

"(*a*) The amount described in section 301-(b)(1)(B)(ii) (regardless of the amount of the distribution under section 301(b)), or

"(*b*) The portion of the adjusted basis of the stock allocable to the property so distributed.

"(iii) The reduction provided in subdivision (i) of this subparagraph shall be made whether or not such distributions were taxable to the parent as ordinary dividends.

"(iv) The reduction provided in subdivision (i) of this subparagraph shall not be made—

"(*a*) To the extent that a reduction in the adjusted basis of the stock is required by section 301(c)(2); or

"(*b*) To the extent that such distributions of the subsidiary are out of earnings and profits of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation.

"(v) The adjusted basis of the subsidiary's stock held by the parent with respect to which the distributions in liquidation are made (reduced as in subdivision (i) of this subparagraph)—

"(*a*) Shall be increased—

"(1) By the amount of any unsecured liabilities assumed by the parent, and

"(2) By the portion of the subsidiary's earnings and profits (less the amount of any distributions therefrom) of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent.

"(*b*) Shall be decreased—

"(*1*) By the amount of any cash and its equivalent received, and

"(*2*) By the portion of the subsidiary's deficit in earnings and profits of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent.

"(vi) For the purpose of subdivision (v)(a)(*2*) and (b)(*2*) of this paragraph—

"(*a*) With respect to property held on the date of purchase and property held on the date additional stock, if any, is acquired any gain or loss from sales or exchanges of such property (whether tangible or intangible) and any other items determined by reference to basis of such property shall be computed by substituting for such basis a new basis determined by reference to the part of the adjusted basis of the stock allocable to such property.

"(*b*) The part of the adjusted basis of stock allocable to such property for the purpose of (a) of this subdivision shall be the basis of the stock held on the date of purchase or on the date of a later acquisition of stock allocated among the assets held on such date on the basis of their net fair market values on such date.

"(*c*) In order to prevent distortion in the adjusted basis of the stock—

"(*1*) Transactions (including distributions, liquidations, and reorganizations) involving a

corporation the affairs of which the subsidiary controls at any time after the date of purchase through ownership of stock (whether or not the subsidiary owns a majority of the stock of such corporation) may be disregarded in whole or in part, and

"(2) Tax-free reorganizations involving the subsidiary may be disregarded in whole or in part, and

"(d) In the case of a subsidiary using the cash receipts and disbursements method of accounting, the earnings and profits of such subsidiary shall be computed for the period specified in subdivision (v)(a)(2) and (b)(2) of this subparagraph as if such subsidiary had used an accrual method of accounting prior to such period.

"(vii) For the purposes of subdivisions (iv), (v), and (vi) of this subparagraph the expression "the date of purchase" means the date of the transaction described in section 334(b)(2)(B) (or, in the case of a series of transactions, the date of the last such transaction), determined without regard to subparagraph (6)(iii).

"(viii) In the case of a distribution by the subsidiary of property directly or indirectly acquired by the subsidiary through a direct or indirect contribution to capital by the parent, the basis of such property to the parent shall be the same as if such contribution had not been made and the adjusted basis of the stock shall not be increased or decreased because of such contribution and distribution. Except as provided in the preceding sentence, the amount of the adjusted basis of the stock

adjusted as provided in this paragraph shall be allocated as basis among the various assets received (except cash and its equivalent) both tangible and intangible (whether or not depreciable or amortizable). Ordinarily, such allocation shall be made in proportion to the net fair market values of such assets on the date received (the net fair market value of an asset being its fair market value less any specific mortgage or pledge to which it is subject). To that portion of the basis thus determined, for each property against which there is a lien, should be added the amount of such lien. Where more than one property is covered by the same lien, the amount of the lien should be divided among the properties, allocating to each that portion of the lien which the fair market value of such property bears to the total fair market value of the properties covered by the same lien. Whether the mortgage indebtedness is assumed by the parent or the property is taken subject to the mortgage is immaterial. The basis of the property received shall be zero if the cash and its equivalent received is equal to or in excess of the adjusted basis of the stock.

"(5) The application of the rules prescribed in subparagraph (4) of this paragraph may be illustrated by the following examples:

"*Example (1).* Corporation A bought all of the stock of Corporation B for $1,000 on January 1, 1955. The only assets of Corporation B was a building having a basis of $100. On July 1, 1955, such building was sold for $1,050. The amount received was invested in another building im-

mediately thereafter. On December 30, 1955, Corporation B was liquidated under section 332 in a transaction in which the basis of the assets in the hands of the recipient corporation was determined under section 334(b)(2). The basis of the stock of Corporation B in the hands of Corporation A is increased by $50 pursuant to §1.334-1(c)(4)(v) and (vi). The basis of the building received by Corporation A upon the liquidation of Corporation B is $1,050.

"*Example (2).* The facts are the same as in example (1) except that the sale price of the building sold was $750. The basis of the building in the hands of Corporation A upon liquidation is $750.

"(6) For the purposes of section 334(b)(2) the term "purchase" means any acquisition of stock, but only if—

"(i) The basis of stock in the hands of the distributee is not determined either in whole or in part by reference to the adjusted basis of stock in the hands of the person from whom acquired, or under section 1014(a) (relating to property acquired from the decedent);

"(ii) The stock is not acquired in an exchange to which section 351 applies; and

"(iii) The stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock. However, if a corporation acquires stock pursuant to an option to buy such stock from a person who, without regard to such option, is not a person the ownership of whose stock would, under section 318(a), be attributed to such corporation,

such stock shall be considered to have been purchased on the date of the acquisition of such option, if such option is exercised on or before the last day of a period of 12 months beginning on the day of the earliest purchase of stock (including the stock subject to such option) used in determining the applicability of section 334(b)(2) and for this purpose the stock with respect to which the option was exercised shall be deemed to have been purchased on the date such option was acquired.

"(7) Section 334(b) does not apply to minority shareholders. The basis of property, other than cash, received by such shareholders shall be determined under section 334(a), 334(c) or 358."

Reg. 1.337-2. Sales or exchanges within the scope of section 337.

* * * (b) * * * For the purposes of this paragraph "property of the type defined in section 337(b)" means property upon the sale of which section 337(a) may provide for the nonrecognition of gain or loss upon sale or exchange during a 12-month period, including property described in subparagraph (A) of section 337(b)(1) if sold or exchanged at any time under the conditions set forth in section 337(b)(2) and including installment obligations acquired in respect of such sale or exchange.

§1.337-3. Property defined.

"Reg. 1.337-3(a) Except as provided in section 337(b)(2) and this section, the term 'property' as used in section 337(a), and §1.337-1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory

of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as 'inventory'), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed above, the term 'property' includes all assets owned by a corporation.

* * *

"*§1.337-4.—Limitation of gain.* * * * *Example.*

Corporation A owns more than 80 per cent of the stock of Corporation B, which it purchased for $10,000. *All of the assets of Corporation B*, having a total basis of $4,000, *are sold* for $12,000. The portion of the realized gain of $8,000, which is not recognized is $6,000, computed as follows:

Basis of stock allocable to property sold	$10,000.00
Basis of property sold	4,000.00
Excess (not recognized)	$ 6,000.00

In general, where section 337(c)(2)(B) is applicable and where the gain realized from the sale of property is greater than the excess of the selling price of the property over the basis of the stock allocable to the property sold, the amount of gain to be recognized from such sale is equal to such excess. In the above example, the $2,000 gain representing the excess of the selling price of $12,000 over the basis of the stock allocable to the property sold ($10,000) would be recognized to the liquidating corporation.

(c) For the purpose of this section only, the basis (adjusted as described in (a) above) of the liquidating corporation's stock in the hands of its parent corporation on the date of the first sale of property, shall be allocated to the assets of the liquidating corporation (unreduced by any amount applicable to minority interests) on the basis of the fair market value of such assets (see §1.334-1(c)), both tangible and intangible, on the date the first property is sold by the liquidating corporation. The allocation then made shall remain unchanged for the purpose of determining recognized gain upon subsequent sales of property by the liquidating corporation unless the stock ownership of the parent corporation change. In the event of such a change, a new allocation shall be made at the time of the next sale of property thereafter. The new allocation shall be made on the basis of the fair market value of the liquidating corporation's assets on the date of such sale.

Reg. 1.453-9(c) Disposition from which no gain or loss is recognized.

"(1) Under section 453(d)(4), no gain or loss shall be recognized to a distributing corporation with respect to the distribution of installment obligations in certain corporate liquidations, under the following conditions:

"(i) If the distribution is made pursuant to a plan for the complete liquidation of a subsidiary meeting the requirements of section 332, to a corporation in the hands of which no gain or loss is recognized with respect to such distribution, or

"(ii) If the distribution is made pursuant to a plan for the complete liquidation of a corporation

which meets the requirements of section 337, under conditions whereby no gain or loss would have been recognized to the corporation had such installment obligations been sold or exchanged on the day of distribution.

"(2) Where the Internal Revenue Code provides for exceptions to the recognition of gain or loss in the case of certain dispositions, no gain or loss shall result under section 453(d) in the case of a disposition of an installment obligation. Such exceptions include: certain transfers to corporations under sections 351 and 361; contributions of property to a partnership by a partner under section 721; and distributions by a partnership to a partner under section 731 (except as provided by section 736 and section 751).

"(3) Any amount received by a person in payment or settlement of an installment obligation acquired in a transaction described in subparagraphs (1) or (2) of this paragraph (other than an amount received by a stockholder with respect to an installment obligation distributed to him pursuant to section 337) shall be considered to have the character it would have had in the hands of the person from whom such installment obligation was acquired."

RULES OF PRACTICE BEFORE THE TAX COURT OF THE UNITED STATES

"Rule 14. Answer.

"(a) Time to answer or move. The Commissioner, after service upon him of the petition, shall have 60 days within which to file an answer or 45 days within

which to move with respect to the petition. (See Rule 22(a) re service of answer.)

"(b) Form of answer.—The answer shall be drawn so that it will advise the petitioner and the Court fully of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute placed upon him. Paragraphs of the answer shall be numbered to correspond to those of the petition to which they relate. The original shall be signed by the Commissioner or his counsel.

"(c) Copies and conformation.—The original and 3 copies of the answer shall be filed, and each copy shall be conformed.

"(d) Application of Rule to amended answers.—This Rule shall apply to the filing of answers to amended petitions and to amendments to petitions, except as the Court in a particular case may otherwise direct."

"Rule 32.—Burden of Proof.

"The burden of proof shall be upon the petitioner, except as otherwise provided by statute, and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent."

APPENDIX B.

Petition to Review Decisions of the Tax Court of the United States.

United States Court of Appeals for the Ninth Circuit.

Family Record Plan, Incorporated (Dissolved) and Family Record Plan, Incorporated, Transferee of Family Record Plan, Incorporated (Disssolved), Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 17,563.

October 22, 1962.

Before: Hamley, Merrill and Duniway, Circuit Judges.

Duniway, Circuit Judge:

In this peittion to review decisions of the Tax Court, the problem presented is strikingly similar to that dealt with by us in *Commissioner of Internal Revenue v. Kuckenberg*, ... F. 2d...., decided October 11, 1962.

Family Record Plan, Incorporated (dissolved), here referred to as Transferor, and Family Record Plan, Incorporated (formerly F.R.P., Inc.), here referred to as Transferee, are the petitioners. There is no substantial dispute as to the material facts.

The period in question is the tax year of Transferor, September 1, 1954 to February 28, 1955. It had for some years been in the business of selling to members of the public the right (represented by a certificate and embodied in a written contract) to have portrait photographs taken at stated intervals, free, by a studio in the customers' vicinity, and an album in which to mount the photographs so taken. A small down payment (usually $5.00 or $10.00) was made, and the bal-

ance was payable, usually at $5.00 per month, over a period, the length of which depended upon which of two types of contracts was used. The maximum contract period was nine months. Transferor carried no stock of albums; it ordered an album from the manufacturer, to be shipped direct to the customer, and this was done, as to each customer, when at least $10.00 had been paid, the cost of the album to Transferor being less than that amount. Transferor had written agreements with a large number of studios whereby the studio agreed to take the pictures and supply one copy to the customer, without cost for the first copy either to Transferor or to the customer. Each customer's contract designated a studio. Once the customer got the album, Transferor's sole remaining responsibility was to designate another studio if the named studio did not perform, or if the customer moved, or, if there were no available studio, to enlarge, retouch, print and return to the customer, a picture from a negative furnished by the customer. There is no showing that Transferor was called upon to perform any of these obligations in connection with any contract assigned, as hereafter described.

Transferee was organized for the purpose of buying the stock of Transferor, liquidating it, and continuing the business. The stockholders of Transferee had no connection with those of Transferor. On October 25, 1954, Transferee bought all of the stock, for $1,120,000. It allocated $800,000 of the price on its books to the cost of the accounts receivable then owned by Transferor, such accounts representing payments owing to Transferor from its customers. After Oc-

tober 25, Transferor was a wholly owned subsidiary of Transferee.

On December 10, 1954, the board of directors of Transferor adopted a plan of complete liquidation, and Transferee, as sole stockholder, consented. The plan required that Transferor cease business, which it did (except as hereafter indicated), and it duly filed the required information return with the Commissioner of Internal Revenue. The plan contemplated sale of "all or any part of the assets" of Transferor. Winding up was to be completed not later than November 30, 1955.

On December 17, 1954, Transferor sold its contracts with its customers, by written agreement, to one Smith and wife. The agreement covered all outstanding contracts, there being about 49,000 with an unpaid balance of $1,390,91, including about 9,000 delinquent accounts in the hands of collection agencies with an unpaid balance of $319,801.77. The Smiths did not undertake to perform the contracts; all that they got was the right to the collections. The sale was without recourse. The purchase price was $800,000, payable $200,000 down and the balance in installments, with the final payment due not later than September 1, 1955. The Smiths' obligation to pay was unconditional. Transferor was appointed agent of the Smiths to collect, the agency being irrevocable until the price was paid or until September 1, 1955, and all collections (net) were to be applied on the price. In fact, Transferor's collections resulted in full payment by April 19, 1955.

Meanwhile, by February 28, 1955, Transferor was fully wound up and dissolved, and all of its assets, in-

cluding the contract with the Smiths, were assigned to Transferee. The transfer of the Smith contract was made as of December 30, 1954. Of the collections on the customer contracts, $225,000 was paid to Transferor, and $575,000 was paid all after January 1, 1955, to Transferee. It is stipulated, however, that if any gain on the sale of the accounts "is recognized to transferor for federal income tax purposes, the amount of the gain to be included in income for the period September 1, 1954, to February 28, 1955, would be $800,000.00."

Both Transferor and Transferee were on the cash basis of accounting. In its final income tax return, Transferor did not include any part of the $800,000 in its income. The Commissioner included all of it, and the Tax Court affirmed the Commissioner. Transferee is in the proceeding solely as a transferee; its liability for tax on its own income is not here involved.

As in *Kuckenberg*, supra, the taxpayers' contention is that the sale of the contracts was a sale of "property" within the meaning of section 337 of the Internal Revenue Code (26 U.S.C. §337) and that therefore no gain or loss to Transferor is recognized for income tax purposes. The Tax Court held that the sale was not a sale of "property," but a sale of "installment obligations" within the meaning of section 337(b). We do not pass upon this question, but expressly leave it undecided, because we think the decision correct for the reasons stated in *Kuckenberg*. We think that here, as there, the Commissioner was entitled, as he asserted before the Tax Court, in the Exercise of his authority under section 446(b) (26 U.S.C. §446(b)), to disre-

gard Transferor's cash basis of accounting and to require computation by a method that would clearly reflect income. Essentially, what was "sold" was a right to receive income generated by Transferor in the regular course of its business, and nothing more; and receipt of $800,000 for that right was the receipt of income.

If the Tax Court was right in its conclusions, we should affirm, even if we think that it applied wrong legal reasons. (*Boe v. Commissioner*, 9th Cir., 1962, ... F.2d .... (Aug. 21, 1962)). In this case, the Tax Court gave taxpayers ample opportunity to present additional evidence as to the application of section 446(b). None was offered. The question, as in *Boe*, is not what are the facts, but what are the legal rules applicable to the facts?

Petitioners also assert that the decision is contrary to the provisions of section 334(b)(2) of the Internal Revenue Code (26 U.S.C. §334(b)(2)). There is nothing in the point. That section deals solely with the "basis," for capital gains purposes, of property received by Transferee, and not at all with the liability of Transferor for tax upon its own income, which is the sole question before us.

Affirmed.

(Endorsed) Opinion Filed Oct. 22, 1962.
Frank H. Schmid, Clerk.

Upon Petitions to Review Decisions of the Tax Court of the United States.

United States Court of Appeals for the Ninth Circuit.

Commissioner of Internal Revenue, Petitioner, vs. Henry A. Kuckenberg, Transferee, Harriet Kuckenberg, Transferee, Lawrence W. Kuckenberg, Transferee, Respondents.

Henry A. Kuckenberg, Transferee, Harriet Kuckenberg, Transferee, Lawrence W. Kuckenberg, Transferee, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 17,538. Oct. 11, 1962.

Before: Hamley, Merrill and Duniway, Circuit Judges

Merrill, Circuit Judge.

Kuckenberg Construction Company, an Oregon corporation, pursuant to a plan of complete liquidation sold and assigned three construction contracts, the income from which had been fully earned, to an independent purchaser for $327,000.00. The company was on the cash method of accounting. The question presented by this review is whether, under § 337(a) of the Internal Revenue Code of 1954,[1] nonrecognition attached to the proceeds of this sale. The tax court held for the taxpayers and the commissioner has peti-

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[1] "General Rule—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

tioned this court for review. We here hold that the proceeds are taxable.

Respondents are the transferees of the assets of Kuckenberg Construction Company. A second question is presented by their contention that they may not, as transferees, be held liable for tax payable by the transferor corporation. We here hold that they are liable.

Upon dissolution of the corporation, the transferees continued the construction business in partnership form. Among the corporate assets was an uncompleted contract known as the "Booth Ranch Contract," which was transferred to respondents for completion. In his notices of transferee liability, the commissioner determined that in order to clearly reflect the corporate income the profits from the Booth Ranch Contract should be allocated between the corporation and the partnership in accordance with the percentage of completion method of computation. The tax court upheld the commissioner in this determination and the transferees have petitioned this court for review. Upon this question we here affirm the ruling of the tax court.

The record discloses the following facts:

From its incorporation under the laws of Oregon on December 6, 1949, until January 14, 1955, the Kuckenberg Construction Company was engaged in the heavy construction business, consisting primarily of road building and related work. During the periods here involved, the corporation maintained its principal office and place of business in Portland, Oregon. Respondents were the officers and directors of the corporation, and at all pertinent times the outstanding capital stock

of the corporation consisted of shares of common stock all of which were owned by respondents.

The corporation employed the cash basis method of accounting and its federal tax returns were filed on this basis.

On December 17, 1954, the board of directors of the corporation adopted and the stockholders approved a plan of complete liquidation of the corporation. The corporation then executed and duly filed with the Corporation Commissioner of Oregon a statement of intent to dissolve pursuant to the provisions of Oregon law.

On December 27, 1954, pursuant to the plan of complete liquidation, the corporation sold and assigned three construction contracts to one Simpson for $327,000.00, payable in installments.

Simpson was not in the construction business, but was a real estate agent and operator. The construction company had completed the work which it was required to perform in connection with these contracts, but settlement had not been made at the time its board of directors decided to dissolve the corporation. In the sale and transfer of the contracts the corporation warranted that the purchaser would receive substantial specified sums in excess of any expenditures which he might have to make under the contract. The corporation also indemnified the purchaser from any liability resulting from the contract and the activities of the corporation thereunder prior to the sale and transfer. In the agreements of assignment with respect to the contract, the corporation guaranteed that each contract "has been or will be fully performed in accordance with its terms." By agreement respondent Henry A. Kuckenberg war-

ranted that the purchaser Simpson, would receive at least $327,000.00 from the three contracts in excess of any expenditures by the purchaser under those contracts, and agreed that upon demand Mr. Kuckenberg would pay any deficit existing on October 1, 1955.

On January 25, 1955, the liquidation of the corporation was accomplished. Liquidating distributions were made to respondents and left the corporation without any assets after December 7, 1955. On that date the corporation filed articles of dissolution with the Oregon corporation commissioner pursuant to Oregon law and on the same date the corporation commissioner issued his certificate of dissolution.

On April 25, 1958, notices of deficiency in the income taxes of Kuckenberg Construction Company for the taxable years 1954 and January 1, 1955, to December 7, 1955, were issued to respondents as transferees of the assets of the corporation. The notices of deficiency and attached exhibits stated that the corporation had been dissolved and liquidated and that its assets had been transferred to respondents during 1955 and that no notice of deficiency was issued to the corporation.

Respondents' position, which was accepted by the tax court, is that the sums realized from the assignment of the contracts constituted "gain from a sale of property" under §337(a) and consequently are not to be recognized for tax purposes.

The commissioner, on the other hand, asserts that had the corporation been on the accrual method of accounting the income from these contracts would have become taxable when earned; that it is only the fact

that the corporation was on the cash basis which has made it possible for this earned income to be transformed into what appears to be a gain from sale; that the cash method of accounting under these circumstances does not clearly reflect income and that the commissioner was therefore within his authority under §446-(b) of the Internal Revenue Code[2] in requiring a computation by a method which would clearly reflect income.[3]

We agree with the commissioner.

In Floyd vs. Scofield, 5 Cir., 1952, 193 F.2d 594, the court dealt with a liquidation of a cash basis corporation in which accounts receivable were distributed to the shareholders. In holding the corporation taxable the court stated (at pages 595-596):

> "The question here, as in Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144, 146, 85 L.Ed. 75, is whether one who is presently entitled to receive income, and who is taxable only on receipt of payment, can escape taxation by giving away his right thereto in advance of actual payment. * * *
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> "To hold that the corporation is not liable in these circumstances would enable it to escape taxation by the simple device of dissolving prior to the

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[2] "Exceptions.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate does clearly reflect income."

[3] The deficiency notice to these taxpayers states:

"It is determined, because of the liquidation of Kuckenberg Construction Co., that there should be taxed to the corporation, in its last taxable period, earnings of $359,446.42 on three certain construction contracts under the provisions of section 446(b) of the Internal Revenue Code of 1954."

actual collection by it of monies fully earned by and payable to the corporation *before* liquidation.

* * *

"The method of accounting employed by the corporation with respect to this transaction does not clearly reflect the corporate income. The Commissioner was well within his authority under Sec. 311, Int. Rev. Code, 26 U.S.C.A. § 311, in reappraising the situation and requiring a computation by a method which clearly and accurately reflects the income in question."

In United States vs. Lynch, 9 Cir., 1951, 192 F.2d 718, 721, this court stated:

"We understand appellant to contend that the income in question is not that of the corporation. The answer is, that the corporation has performed the services which create the right to the income which brings into play the basic rule that income shall be taxed to him who earns it. Helvering v. Eubank, 1940, 311 U.S. 122, 61 S.Ct. 149, 85 L.Ed. 81. A corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assignment of such income."

In Williamson vs. United States, Ct.Cl., 1961, 292 F.2d 524, where the court, under similar circumstances, followed Floyd vs. Scofield, supra, it was stated at page 530:

"In any case the outcome hinges upon whether there had been a realization of income by the distributing corporation. It is fundamental that all economic gain is not taxable income and that it is

> the realization of income that is the taxable event. But the law contemplates that there is some point at which all income which has accrued, in the sense of having been fully earned, will be realized and taxable to him who earned it regardless of the accounting method involved. An acceptable accounting method should simply indicate this point logically and consistently."[4]

Respondents protest that these were cases of distribution of assets to shareholders under §§ 311 or 336; that the case at bar is one of a sale by a liquidating corporation clearly falling within § 337(a); that to sanction the commissioner's authority to change the method of accounting under these circumstances is to deprive respondents of a right clearly and expressly bestowed by § 337(a).

We cannot agree. The purpose of § 337(a) was to eliminate the formal problem created by Commissioner of Internal Revenue vs. Court Holding Co., 1945, 324 U.S. 331, and United States vs. Cumberland Public Service Co., 1950, 338 U.S. 451, by achieving uniformity of tax treatment for the sale of assets by a liquidating corporation and the sale of assets by shareholders to whom the assets had been distributed in liquidation.[5]

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[4]These principles have also been recognized by this court in Idaho First National Bank vs. United States, 9 Cir., 1959, 265 F.2d 6.

[5]The Senate report relating to § 337 states:

> "Section 337 * * * concerns the problems raised by the decisions in Commissioner v. Court Holding Co. * * * and United States v. Cumberland Public Service Co. * * * and the numerous related cases. These decisions involve the question of whether the corporation or the shareholder effected a sale of property in connection with the liquida-

Section 337 was thus intended to erase a formalistic inequity and not to create one. We find no suggestion or intimation that it was ever contemplated that a cash basis taxpayer was to receive unequal and advantageous treatment over an accrual basis taxpayer through his ability to avoid the consequences of an anticipatory assignment of earned income.

We conclude that the commissioner was within his authority in computing income by the method selected; that the proceeds of the assignment of these construction contracts constituted recognized income to the liquidating corporation.

Respondents contend, for three reasons, that even accepting corporate liability for the tax in question, they may not be held liable as transferees of the corporation's assets under § 6201 of the Internal Revenue Code.

First they assert that the United States does not have the status of a creditor since no ninety-day letter was sent to the corporation. However, the government need not take futile assessment action against a taxpayer without assets. Ginsberg vs. Commissioner of Internal Revenue, 2 Cir. 1962, 305 F.2d 664; Flynn

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tion of the corporation. Under the decision in Cumberland Public Service Co., supra, it is indicated that in the case of a distribution of property in liquidation of a corporation followed by its sale made in fact by its shareholders, a single tax is imposed at the shareholders level. Where the shareholders in fact did not effect the sale tax is imposed both at the corporate and at the shareholder level. Accordingly, under present law the tax consequences arising from sales made in the course of liquidations may depend primarily upon the formal manner in which the transactions are arranged. Your committee intends in section 337 to provide a definite rule which will eliminate the present uncertainties." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 258.

vs. Commissioner of Internal Revenue, 5 Cir., 1935, 77 F.2d 180.

With respect to the procedural requirement of notice of deficiency, H. Conference Rep. No. 356 (1939-Cum. Bull., Part 2, 361, 372) states the intention of Congress very explicitly as follows:

> "Section 274(a) [predecessor of Sections 6212 and 6213 of the 1954 Code] requires notice of a deficiency in a tax to be sent the taxpayer before further proceedings for collection of the tax liability are continued. The section, however, in terms applies only to a deficiency in a tax and does not apply to the liability of a transferee in respect of the tax of the taxpayer. Therefore, in proceedings against the transferee, notice need not be given the taxpayer under section 274(a). However, under the substitute agreed to by the conferees, the liability of the transferee is collected in the same manner as the liability for tax. Section 274(a) is thus incorporated by reference, but the result of such reference is that for procedural purposes the transferee is treated as a taxpayer would be treated, and under section 274(a) notice would be sent to the transferee (and not the taxpayer) in proceedings to enforce the liability of the transferee."

Next, respondents assert that the United States, by failing to comply with the provisions of Oregon law has failed to perfect its right to proceed against transferees. Specifically, it is asserted that Oregon requires the creditor to proceed to judgment and a return of execution nulla bona.

It is necessary, under Commissioner vs. Stern, 1958, 357 U.S. 39, to look to state law in order to determine the transferee's substantive liability. However, the court in Stern assumed as a matter of course that the transferee provisions of the Internal Revenue Code governed the procedure the commissioner had to follow in asserting and enforcing that liability. The United States, in seeking to collect federal taxes, was not expected by Congress to follow the procedural intricacies of every one of the fifty states.[6] Oregon law here provides, when proper steps are taken, that these transferees shall be liable. That suffices.

Third, respondents contend that to assert transferee liability the government must reach the trust fund; that the transferees put the money in a partnership which, under Oregon law, is a separate entity. Therefore, the government should have proceeded against the partnership rather than the partners.

We feel there is no merit to this contention. Respondents were the recipients and, as partners, are still in ownership and control.

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[6]See Ginsberg v. Commissioner of Internal Revenue, 2 Cir., 1962, 305 F.2d 664.

The legislative history of the transferee liability provisions of the Code shows that they were designed to facilitate proceedings against transferees in the same manner as against a taxpayer and to eliminate the need for previous cumbersome procedures. The pertinent legislative history concerns §280, Revenue Act of 1926, c. 27, 44 Stat. 9, from which §311 of the 1939 Code (discussed in Commissioner vs. Stern, supra) and §6901 of the 1954 Code, here in issue, were derived. Provisions with respect to the limitation of the period for assessment against a transferee were added initially in §311(b) of the Revenue Act of 1928, c. 852, 45 Stat. 791. No pertinent changes from prior law were made in §6901 of the 1954 Code. H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A422-A423; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 599.

We conclude that respondents, as transferees, are liable for the unpaid tax of the corporation.

Respondents have petitioned for review of the tax court's decision upholding the commissioner in his determination that tax was due from the corporation on the "Booth Ranch contract." This contract, uncompleted by the corporation, was assigned to taxpayers and profitably completed by them. At the time of assignment the corporation had incurred a substantial portion of the total expense of the contract and had performed substantial work on it. On its cash basis the corporation had reported a loss.

The commissioner determined that the cash method did not clearly reflect income and, under § 446(b), applied the percentage of completion method, by which he determined income to the corporation in 1955 from the Booth Ranch contract of $6,566.63. He was upheld by the tax court.

Respondents concede that the commissioner has authority under § 446(b) in proper cases to change a taxpayer's accounting methods from completed contract to percentage of completion. Jud Plumbing & Heating vs. Commissioner, 5 Cir., 1946, 153 F.2d 681; Standard Paving Co. vs. Commissioner, 10 Cir., 1951, 190 F.2d 330. They contend, however, that such a change cannot be based solely on hindsight but must be based on the known facts at the date of distribution. Here, they assert, at the time of distribution, there was no way of knowing whether the contract would prove profitable. They point to an earlier tax court decision holding that for purposes of determining capital gain on

distribution of this contract, the contract had no fair market value. 19 T.C.M. 1546 (1960).

In that decision the court had stated:

> "Petitioner, Henry A. Kuckenberg, who was the president of the corporation and the directing head of its business operations, testified at the hearing and gave as his opinion that the contract had no fair market value at the time it was assigned. The gist of his testimony was that at the time the contract was assigned no one knew or could know whether or not the contract would be profitable. He testified that the company expected to make a profit when it took a contract such as this one but that this expectation did not always turn out to be true, that sometimes in the experience of the corporation it had completed a contract at a loss."

Such uncertainty is not unusual. While fairly bearing on the question of capital gain we feel it is no basis for denying authority to the commissioner to change the corporation to a percentage of completion method where the cash method did not clearly reflect income.

Upon the petition of the commissioner, the tax court is reversed.

Upon the petition of respondents, the tax court is affirmed.

(Endorsed) Opinion Filed Oct. 11, 1962.

Frank H. Schmid, Clerk.

Opinion of the Tax Court of U. S. Family Record Plan.

Family Record Plan, Incorporated (Dissolved).

Docket Nos. 75771, 75790, 5-19-61. Opinion by Train, *J.* Years 1954-1955. Decision for Commissioner.

After the transferor had adopted a plan of complete liquidation, its accounts receivable were sold. Held: the present accounts receivable are installment obligations within the meaning of section 337(b) of the 1954 Code and gain from their sale is recognized.

Harold Easton, Esq., and Robert L. Spencer, Esq., for the petitioners.

Jack E. Roberts, Esq., for the respondent.

Train, *Judge:* Respondent determined a deficiency in income taxes for the period September 1, 1954, to February 28, 1955, and transferee liability as follows:

Family Record Plan, Incorporated (Dissolved) Docket No. 75771	$411,641.70
Family Record Plan, Incorporated, Transferee of Family Record Plan, Incorporated (Dissolved) Docket No. 75790	411,641.70

The sole question presented is whether the sale of accounts receivable comes within the non-recognition of gain provisions of section 337 of the 1954 Code.

FINDINGS OF FACT

Some of the facts have been stipulated *and* are hereby found as stipulated.

The petitioner in Docket No. 75771, Family Record Plan, Incorporated (Dissolved), (hereinafter referred to as the transferor) was a corporation organized and

existing under the laws of the State of California, with its principal place of business in Los Angeles, California. The transferor kept its records and filed its Federal income tax returns on the cash receipts and disbursements methods of accounting. At no time did transferor elect to use the installment method of accounting as permitted under the Internal Revenue Code.

The petitioner in Docket No. 75790 Family Record Plan, Incorporated, Transferee of Family Record Plan, Incorporated, (Dissolved), (hereinafter referred to as the transferee) is a corporation organized and existing under the laws of the State of California with its principal place of business in Los Angeles, California. At the time of its incorporation the company's name was F.R.P., Inc., but was later changed to Family Record Plan, Incorporated.

Throughout its corporate existence, transferor engaged in only one type of business. Through the medium of sales representatives in various parts of the United States it entered into contracts with customers which provided that transferor would furnish to the customer certain goods and services for a specified price. The items to be received by each customer were a leather album for keeping photographs as well as the right, during a designated period of time, to have a specified number of photographs taken by a photographer to be selected from a list given to the customer. The photographers on this list had previously

entered into agreements with the transferor to furnish the photographs free of charge. The price charged to the customer was to be paid by a specified down payment at the time the contract was signed, with the balance payable in equal monthly amounts thereafter. All of the accounts receivable from customers which were owned by transferor on the date of its adoption of a plan of liquidation and on the date when such accounts receivable were sold, arose as aforesaid from the business operations of transferor or its predecessor partnership.

On October 25, 1954, all of the outstanding capital stock of transferor was purchased by transferee. The purchase price paid for the stock was $1,120,000. Of the total purchase price of $1,120,000 paid for the capital stock of the transferor, the transferee allocated on its books an amount of not less than $800,000 as the cost attributable to the accounts receivable then owned by transferor.

The selling stockholders of the transferor had no proprietary or other interest in the corporation which purchased their stock (transferee), except as creditors for the payment of the balance of the purchase price. After October 25, 1954, they had no further interest in the transferor. Neither were they related by kinship, marriage or otherwise to the stockholders of the purchasing corporation (transferee).

The purpose of transferee in purchasing the capital stock of transferor was to dissolve transferor and take over its assets,

On December 10, 1954, the board of directors of transferor adopted a plan of complete liquidation, which directed that transferor cease business, sell those assets which it wished to, and distribute the remainder of its assets, subject to its liabilities, to its stockholders. The sole stockholder (transferee) consented to the plan of liquidation on December 10, 1954. In compliance with this plan, transferor ceased business forthwith, and made no sales after December 10, 1954. On December 31, 1954, transferor filed with respondent form 966, "Return of Information under Section 6043 of the Internal Revenue Code to be filed by Corporations within 30 Days after Adoption of Resolution or Plan of Dissolution or Complete or Partial Liquidation".

On December 17, 1954, transferor sold, without recourse, all of the accounts receivable from customers then owned by it for the price of $800,000 payable $225,000 in cash at that time and $575,000 in deferred payments. The purchasers of the accounts receivable were Morton Smith and Doris Smith of Providence, Rhode Island, who were not employees, officers, directors or stockholders of the transferor or the transferee. The accounts receivable thus sold consisted of approximately 49,000 accounts (including approximately 9,000 accounts theretofore turned over to collection agencies for collection) aggregating an unpaid balance of approximately $1,300,331.91 (including approximately $319,801.77 theretofore turned over to collection agencies for collection).

Payments on the $800,000 selling price of the accounts receivable were made to transferor and transferee as follows:

Date of Payment		*Amount*
Check payable to and deposited by transferor:		
December 30, 1954		$225,000
Checks payable to and deposited by transferee:		
January 31, 1955	$245,000	
March 1, 1955	115,000	
April 1, 1955	140,000	
April 19, 1955	45,000	575,000
Total		$800,000

Subsequent to the sale of its accounts receivable, and by February 28, 1955, transferor distributed in complete liquidation to its sole stockholder (transferee) all of its assets, subject to its liabilities, and thereupon dissolved. In connection with this liquidation, on December 29, 1954, transferor executed a written assignment to transferee, transferring as of December 30, 1954, all of transferor's assets including the agreement of sale of accounts receivable. The fair market value of the assets transferred by the transferor to the transferee was in excess of $550,000.

Following the purchase of the stock of the transferor by the transferee the transferor did not hold stock in any corporation nor was said transferor utilized for the manufacture, construction, production, or purchase of any property with a view to the realization by its shareholders of gain attributable to such property other than as dividends.

In its final Federal income tax return for the period from September 1, 1954, through February 28, 1955, transferor did not recognize as taxable income any gain attributable to the sale of its accounts receivable. No part of the tax determined by respondent resulting from the sale of accounts receivable has been paid by transferor.

OPINION

The transferee liability of the petitioner in Docket No. 75790 for any taxes which may be found due from the petitioner in Docket No. 75771 has been conceded.

The respondent has conceded that the transferor was not a collapsible corporation within the meaning of section 341 of the 1954 Code.

The sole question for decision is whether the sale of the transferor's accounts receivable comes within the non-recognition of gain or loss provisions of section 337 of the 1954 Code. The problem resolves itself around whether or not the accounts receivable are installment obligations and thus excluded from the meaning of "property" as that term is used in section 337(a).[1]

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[1] SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

Section 337(b)[2] excludes installment obligations from the definition of property as used in section 337(a). However, the section contains no definition of "installment obligations". In its report with respect to sections 337(b)(1) and (2), the Senate Committee on Finance stated:

> Paragraph (2) of subsection (b) provides a special rule which would include inventory within the term "property" in any case in which substantially all of the inventory is, under section 337, sold or exchanged to one person in one transaction. In such case installment obligations acquired in respect of such sale or exchange are also included

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[2](b) Property Defined.—

(1) In general.—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with respect to inventory in certain cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

as property. *It is intended that, during the 12-month period, sales in the ordinary course of business shall result in ordinary gain to the corporation as if the corporation were not in the process of liquidating.* Your committee intends that where a bulk sale of the inventory assets is made at the beginning of the 12-month period, that no replacement of inventory or the acquisition of a new kind of inventory to conduct ordinary business for the balance of the 12-month period will be allowed. Thus, the bulk sale referred to will ordinarily be the last sale made by the corporation of its inventory. *Installment obligations arising out of sales in the ordinary course of business shall be treated as inventory.* [Emphasis added.] [S. Rept. No. 1622, 83d Cong., 2d Sess., p. 259 (1954).]

It is petitioners' contention that the term "installment obligations" as used in section 337(b) has long been held to mean only those obligations resulting from the sale of property, as to which the seller has properly elected to report gain under the so-called installment method now provided for in section 453. Petitioners point out that as far back as 1931, the Internal Revenue Service distinguished between an installment obligation as to which the income was reported on the installment basis, and an obligation not so reported. G.C.M. 9114, X-1, C.B. 437 (1931).[3]

[3] * * * it appears that the term "installment obligations" as used in section 44(d) contemplates an evidence of indebtedness of a purchaser acquired by a seller in connection with the sale of property, the income from which is reported on the installment basis. In the instant case, under the Revenue Act of 1924 the transaction was clearly a deferred payment sale of personal property not on the installment basis and was treated as a

Petitioners also point out that this distinction was made in Joseph Frost, 37 B.T.A. 190 (1938).[4] Based on this analysis, petitioners contend the accounts receivable sold by the transferor were not "installment obligations" since the transferor did not elect or use the installment method of reporting. On the contrary, petitioners contend that the transferor has always used the cash basis of reporting which, they argue, cannot give rise to "installment obligations."

We do not agree with petitioners' contention. The clear intent of Congress was that sales in the ordinary course of business would result in ordinary gain to the corporation as if it were not in the process of liquidating. If we were to adopt transferor's contention, a cash basis taxpayer would be able to sell merchandise on credit, then sell his accounts receivable acquired in the ordinary course of business and have no recognizable gain. Conversely, an accrual basis taxpayer or a taxpayer using the installment method under section 453 would have a recognizable gain in a similar transaction. Transferor's position is contrary to the intent of Congress and cannot be sustained. Insofar as petitioners' reliance on the language of Joseph

completed transaction in 1924. It is concluded, therefore, that the notes in the instant case do not constitute "installment obligations" as that term is used in section 44(d). * * * [G.C.M. 9114, X-1 C. B. 137 (1931).]

[4]The contracts of sale which the petitioner had were not installment obligations within the meaning and intendement of section 44(d), since he was not using the installment basis, and there would be no good reason to characterize them as installment obligations. The section was enacted as a part of the 1928 Act to prevent evasion under the installment method of reporting income[3] and was not intended to apply where some other unrelated method of reporting had been used. * * * [Footnote omitted] [37 B.T.A. 190 at p. 192.]

Frost, supra; this is also misplaced. We said there that the contracts of sale were not installment obligations within the meaning of section 44(d) of the 1939 Code since the taxpayer was not using the installment basis. We did not say that the contracts were not installment obligations, but rather that they were not such within the meaning of section 44(d).

Petitioners contend that the source of the term "installment obligations" is in section 453(d) of the Code, which contains special rules for taxing gain or loss on disposition of installment obligations. These special rules impose limitations on the privilege of deferring tax through use of the installment method accorded by section 453(a) and (b) of the Code. Petitioners point out that these limitations were first contained in section 44(d) of the Revenue Act of 1928, with respect to which the House Ways and Means Committee report stated:

> The installment basis accords the taxpayer the privilege of deferring the reporting at the time of sale of the gain realized, until such time as the deferred cash payments are made. To prevent the evasion the subsection terminates the privilege of longer deferring the profit if the seller at any time transmits, distributes, or disposes of the installment obligations and compels the seller at that time to report the deferred profits. [H. Rept. No. 2, 70th Cong., 1st Sess., p. 16 (1928).]

Because of the special nature of obligations as to which the privilege of the installment method of reporting is

elected, transferor points out that other Code provisions also contain special rules relating to them.[5]

In sections other than section 337, petitioners contend it is obvious that wherever the term "installment obligations" is used, it is used in its specialized sense under section 453. In each of the instances just cited, as well as others, the special tax treatment of an installment obligation required by the statute would not apply to an identical obligation as to which the installment method had not been elected. Thus, if an installment obligation is given away, the donor immediately realizes any previously unreported gain represented by the obligation, by reason of section 453(d). No such tax result obtains, however, if he gives away an obligation, identical in all respects except that the installment method of reporting was not elected with respect thereto.

We see little merit in this contention. If the term "installment obligations" was a phrase of art, no reference to section 453 would be necessary when it was used. It is significant that each time the phrase is used in sections 336, 381, and 691, there is a specific reference to section 453. However, when "installment

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[5]Section 336 states, "Except as provided in section 453(d) (relating to disposition of installment obligations), no gain or loss shall be recognized to a corporation on the distribution of property in partial or complete liquidation."

Section 381(c)(8) provides, "If the acquiring corporation acquires installment obligations (the income from which the distributor or transferor corporation has elected, under section 453, to report on the installment basis) the acquiring corporation shall, for purposes of section 453, be treated * * *."

Section 691(a)(4) states, "In the case of an installment obligation received by a decedent on the sale or other disposition of property, the income from which was properly reportable by the decedent on the installment basis under section 453, if such obligation is acquired by the decedent's estate * * *."

obligations" was used in section 337(b) there was no reference to section 453. In view of the congressional intent expressed in the committee report set out above, we believe it clear that the term is not limited to situations where the taxpayer has elected to use the installment method.

Petitioners also rely on Henry A. Kuckenberg, 35 T.C. — (December 30, 1960),[6] to support their contention that the accounts receivable are not "installment obligations."

In that case, we decided that three contruction contracts were property within the meaning of section 337(a) and not excluded from the nonrecognition provisions by section 337(b). However, our opinion did not specifically consider whether those contracts represented "installment obligations," and we do not consider the decision in that case to be controlling here.

Petitioners point out that a well-settled rule has developed from numerous court decisions that if a parent corporation purchases the stock of a subsidiary corporation solely for the purpose of obtaining the subsidiary's assets, the transaction is treated as in substance the

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[6] 35 T.C. — (December 30, 1960), at p.

It seems to us that these facts, coupled with other facts stated in our findings, bring the gain realized from the sale of the three contracts within the nonrecognition provisions of section 337 of the 1954 Code. It certainly cannot be contended, we think, that contracts such as these sold to Simpson do not constitute property. Simpson certainly must have purchased them as property from which he expected to make a profit. The uncontradicted evidence is that Simpson realized a profit of $32,446.42 from the transaction. This profit would, of course, be taxable to him and not to the corporation. The property which these contracts represented, it seems to us, is not excluded from the nonrecognition of gain or loss provisions of section 337(b), printed in the margin.

acquisition of the assets. Petitioners, therefore, contend the basis of the assets to the parent is the cost to it of the subsidiary's stock citing Kimbell-Diamond Milling Co., 14 T.C. 74 (1950), aff'd. 187 F.2d 718 [40 AFTR 328] (C.A. 5, 1951), certiorari denied 342 U.S. 827 (1951), as authority for this proposition. Under this rule, it is contended the transferee in effect purchased all of the assets of the transferor for $1,120,000, the purchase price of transferor's capital stock. Petitioners contend that it has been established that the portion of this price allocable to the transferor's accounts receivable was at least $800,000 and since the receivables were sold shortly thereafter for $800,000, in substance, the assets were sold by the transferee, which realized no taxable gain thereon.

This contention has no merit. The facts show that the *transferor* and *not* the transferee sold the accounts receivable; therefore, the tax liability is attributable to the transferor. Even if we assume that petitioners' contention is correct, it is all the more evident that the transferor is liable for the tax due. If the transferee, in effect, bought the assets of the transferor, as contended, then necessarily there was a sale of the accounts receivable and since the transferor received cash, there was a realization of income. Transferee's liability arises only by reason of being a transferee and not by reason of the sale of the accounts receivable.

The transferor received only $225,000 of the $800,000, for which the accounts receivable were sold

and remaining $575,000 was received by the transferee. It is true that the transferor was on the cash basis, but a corporation being a separate legal entity, its net earnings, whether ascertained or not, belong to it, and the tax upon unexempt income in each taxable year is chargeable to it, and this liability cannot be discharged by the simple expedient of dissolution and the turning over of all its assets, including current and unreported income, to its sole stockholder, even though such corporation receives no money consideration for the transfer of such income. It is the actuality of income rather than its disposition that is important in determining the tax consequence. Jud Plumbing & Heating v. Commissioner, 153 F.2d 681, 684 [34 AFTR 1025] (C.A. 5, 1946).

In the ordinary case, a cash basis taxpayer who acquires the right to receive income is taxed when he receives it, regardless of the time when his right to receive payment accrued. But the rule that income is not taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income, can escape taxation because he has not himself received payment of it from his obligor. The rule, founded on administrative convenience, is only one of postponement of the tax to the final event of enjoyment of the income, usually the receipt of it by the taxpayer, and not one of exemption

from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of money or property. Cf. Aluminum Castings Co. v. Routzahn, 282 U.S. 92, 98 [9 AFTR 567] (1930); Helvering v. Horst, 311 U.S. 112 [24 AFTR 1058] (1940).

The express intent of Congress is clear. Accordingly, we hold that the accounts receivable are installment obligations within the meaning of section 337(b) and the gain on their sale is to be recognized.

Reviewed by the Court.

Decisions will be entered for the respondent.

APPENDIX C.

Conflicting Opinion.

United States of America, Appellant, v. M. O. J. Corporation, Appellee. No. 17886. United States Court of Appeals Fifth Circuit. Jan. 19, 1960.

Before RIVES, Chief Judge, and HUTCHESON and TUTTLE, Circuit Judges.

TUTTLE, Circuit Judge.

The United States appeals from a judgment of the District Court, sitting without a jury, granting a tax refund to the taxpayer corporation. The facts being largely stipulated, and not otherwise being in dispute, the only question presented here is whether the trial court erred in holding that the liquidation by the taxpayer of its four wholly owned subsidiaries was not a Section 112(b)(6) liquidation[1] resulting in no gain to

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[1] 26 U. S. C. A. (I. R. C. 1939) §112(b)(6), in material part follows:

"§112. Recognition of gain or loss.

* * * * *

"(b) Exchanges solely in kind—

* * * * *

"(6) Property received by corporation on complete liquidation of another.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

"(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property

it upon receipt of the property of its liquidated subsidiaries, but was merely a step in the unitary plan to acquire the underlying assets of its subsidiaries and was thus to be accorded the effect of what is now known to the initiated as the Kimbell-Diamond doctrine. Kimbell-Diamond Milling Co. v. Commisssioner, 14 T.C. 74, affirmed 5 Cir., 187 F.2d 718. The significance of this holding by the District Court in this case is that, if it was not a Section 112(b) (6) liquidation, then the provisions of Section 113(a) (15)[2] that the basis of the property acquired from the dissolved corporations shall remain the basis in the hands of the

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the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

* * * * *

"(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or * * *" 26 U. S. C. 1952 ed. §112.

[2]26 U. S. C. A. (I. R. C., 1939) §113(a) (15), provides in material part as follows:

"§113. Adjusted basis for determining gain or loss.

"(a) Basis (unadjusted) of property.—The basis of property shall be cost of such property; except that—

* * * * *

"(15) Property received by a corporation on complete liquidation of another.—If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112(b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113(a) (15) of the Revenue Act of 1936, as amended, shall, in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended. * * *"

parent corporation do not apply; thus, the basis would be the amount paid by the taxpayer for the stock in the original corporations which owned the assets before dissolution.

The taxpayer was organized largely upon the instigation of former employees of four corporations owned and controlled by the Johnston family. The stipulation between the parties in this suit, introduced on the trial, stated:

> "Plaintiff was incorporated under the laws of Delaware on September 25, 1951, with an authorized capital stock of 672,000 shares of common stock of a par value of $1 each. Plaintiff was formed for the purpose of acquiring control of and continuing the operation of the business enterprise owned and operated by the corporations listed in paragraph 1' [the four existing 'Johnston' companies.]."

The testimony of witnesses for the taxpayer was unimpeached and must be taken for true to the effect that the only way any other than the existing four companies could get ownership and control of the property and businesses belonging to these companies was by purchasing the stock of the companies and thereafter dissolving them.[3] It is also undisputed that the plan devised was that a new corporation, the taxpayer here, would be organized with sufficient capital to per-

[3]This is readily understandable, because if such assets were sold after having appreciated in the hands of the original owner, the corporate owner would thus be subject to a corporation income tax on the gain and the stockholders would thereafter be subject to a tax on liquidating the corporation if there was a gain over their basis in the stock.

mit it to buy up the outstanding stock of the four companies; as the sole stockholder it would then dissolve them and thus acquire ownership of all their assets, and thus be in a position to continue the businesses theretofore carried on by them.

Sufficient stock was sold to the public to provide, when added to the amount paid in by the aforementioned promotors of the project, the four million dollars agreed to be paid for the entire outstanding capital stock of the existing companies; M. O. J. Corporation then held its organizational meeting, voted its stock in the other corporations to cause their dissolution and then transferred all of their assets to it; thereafter M. O. J. Corporation continued to operate the far-flung businesses previously carried on by the Johnston companies.

The taxpayer asserted the right to assign a basis of four million dollars to the assets thus acquired. The Commissioner contended that this was a taxfree liquidation under Section 112(b) (6) of the Internal Revenue Code of 1939, and that the basis in the hands of the taxpayer remained as it had been in the hands of the transferors. The district court held against the Commissioner, deciding that this was not a liquidation as contemplated by Section 112(b) (6), but was, instead, a purchase by M. O. J. Corporation of all of the assets, including the going concern value and good will of the four original operating companies. The court found that under the principle which we approved in Kimbell-Diamond Milling Co., supra, the fact that the purchase was accomplished by means of buying all the stock in, and then dissolving, the original corporate owners was

an irrelevant fact in determining the rights of the parties.

We agree, and affirm the judgment of the trial court. The case is not without real difficulties. Not the least of these is that in this field of taxation in which the incidence of taxation is always fixed by statute and by statute alone, we begin with a law which says that when a corporation circumstanced as was M. O. J., receives property "distributed in complete liquidation of another corporation" the basis of such property "shall be the same as it would be in the hands of the transferor."

Our problem is simplified, however, because all the courts that have had occasion to deal with the matter, and the Commissioner as well as taxpayers and their counsel, agree that not every receipt by a corporation of property resulting from its dissolution of a subsidiary constitutes a receipt of such property "distributed in complete liquidation of" the other corporation. We, therefore, consider the circumstances which the courts have heretofore considered as not being within the legislative scheme contained in Section 112(b) (6).

The first case decided by an appellate court which thus held was Commissioner of Internal Revenue v. Ashland Oil & Refining Co., 6 Cir., 99 F.2d 588, but for some reason the principle there enunciated has taken the name of a later case decided by the Tax Court and affirmed by us, Kimbell-Diamond Milling Co. v. Commissioner, supra. The principle has been most recently articulated by this Court in Georgia Pacific Corporation v. United States:

> "This succinctly stated is that when stock in a corporation is purchased for the purpose and with

the intent of acquiring its underlying assets and that purpose continues until the assets are taken over, no independent significance taxwise attaches to the several steps of a multiple step transaction. The final step is, therefore, viewed not as independent of the stock purchase but simply as one of the steps in a unitary transaction, the purchase of assets." Georgia Pacific Corporation v. United States, 5 Cir., 264 F. 2d 164, 163.

In Kanawha Gas & Utilities Co. v. C. I. R., 5 Cir., 214 F.2d 685, a case most like the Ashland case, we said:

"* * * The Tax Court referred to Section 141 of the Revenue Act of 1928. Articles 37 and 38 of Regulations 75 applicable to the taxable year 1929 and subsequent years, and Internal Revenue Code Section 113(a) (11), and held that the petitioner is so limited. Concededly, that would be the correct result if petitioner acquired the stocks of the eight corporate vendors intending to assume and, for so long as conditions warranted, to maintain the relation of parent to subsidiaries. Actually, however, petitioner acquired those stocks solely as a means of acquiring their physical properties, intending throughout to cause the corporate vendors to distribute their assets in liquidation to petitioner as soon as it acquired legal title to the stocks; and petitioner promptly executed that plan in accordance with its terms. * * *" 214 F.2d 685, 689-691.

The most recent case we have found dealing with the matter is United States v. Mattison, 9 Cir., 273 F.2d

13. There, although not a Section 112(b) (6) case but rather a case arising under Section 115(c), 26 U.S.C.A., I.R.C. 1939, the Court of Appeals for the Ninth Circuit applied the same principle in a case in which the following were the facts: Taxpayer had a contract with Continental Oil Company to buy from him all the operating assets and inventory of Westcott Oil Company. Mattison bought the Westcott stock, liquidated Westcott and transferred to Continental the assets it had agreed to buy and, during liquidation, turned the remainder of Westcott's assets into cash which was finally turned over to Mattison in final liquidation. The Court, finding that Mattison acquired the stock in Westcott and dissolved Westcott for the purpose of carrying out his agreement to sell its operating properties and inventory to Continental, applied the Kimbell-Diamond rule and held that this was not a true liquidation under Section 115(c) but a purchase of property by Mattison.

The next difficulty we consider is posed by the contention of the government that in each of the cases in which the courts have thus far applied the doctrine, the acquiring corporation or individual, as in Mattison, had as the sole purpose for acquiring the stock and dissolving the owner corporation the desire to acquire a certain property or species of assets, generally to integrate them into the continuing business of the purchaser. It is true that in each of the cases mentioned such was the stated purpose: in Ashland, to acquire oil producing properties; in Kimbell-Diamond, to obtain a flour mill to replace one lost through fire; in Kanawha Gas & Utilities Co., to acquire oil and gas leases and

equipment; in Georgia Pacific Corporation, to purchase a large stand of timber; and in Mattison to acquire certain operating assets and inventory.

We recognize that in none of these cases was there a purpose to do what was here the clear intention of the parties, which was to acquire control of and continue the operation of the business enterprise owned and operated by the existing corporations. Here the business was being conducted in twenty-four different states and some foreign countries. Taxpayers' witnesses testified that "the intention was to have the business continue to operate with as little impact from change of ownership as possible" and that it was their desire to continue to trade on the good will which had been created by the old companies in their long history. Instead of acquiring an asset to be utilized in the business of a parent corporation, this taxpayer was created for the purpose of stepping as unobtrusively and effectively as possible, and with all the old organizations intact, into the shoes of the existing going businesses.

These circumstances, says the Commissioner, take this case out of the class of cases that have developed the Kimbell-Diamond Doctrine. We recognize that no case in which the ultimate purpose was to continue the existing businesses under a new corporate structure has applied the doctrine, but we know of no appellate court case in which the issue has been raised. The Commissioner cites, as persuasive authority for the proposition that we should not here apply the Kimbell-Diamond principle, the two cases of John Simmons Co. v. Commissioner of Internal Revenue, 25 T.C. 635, and Trianon Hotel Co. v. Commissioner of Internal Revenue,

30 T.C. 150. We recognize that the distinction which the Tax Court points out there is present here, but with deference to the careful analysis and treatment by that court of the problem at hand, we think the real basis of the Kimbell-Diamond rule lies elsewhere.

[1] If, in fact, the stock in a corporation must be bought in order to obtain that corporation's assets, there is no more justification for treating the acquisition of the stock and dissolution of the corporation as two steps giving rise to tax incidence where it is desired to continue the business of the original corporation than where the acquisition of the stock and dissolution are for the purpose of obtaining the property or assets for their own separate intrinsic value. The essential thing is that here is a corporation that wishes to acquire the assets of another corporation; it does not want the intervening corporate structure; it never intends to keep it in existence for any of the many reasons that one corporation may desire to operate a wholly owned subsidiary as a separate entity; it therefore never intends for it to be a real subsidiary and it never is, in fact, except just long enough to be dissolved. Assuming the correctness of the decision of all of the courts that when this situation exists as a part of a plan to buy specific property the purchase of the stock and liquidation of the corporation owning the property is disregarded we perceive no difference conceptually when it exists as a part of a plan to buy a going business.

[2] In short, we conclude that the justification for so construing the language of Section 112(b)(6) as to exclude the purchase of specific property through the

purchase of stock in its corporate owner is that what results in the "receipt by a corporation of property" is not a "distribution in complete liquidation of another corporation," but is in real substance the purchase of the property, which is accomplished, for reasons beyond the control of the purchaser, by the purchase of stock and dissolution of the corporate owner. This is just as true if "the property" is the going business of the transferor as if it is a flour mill or oil well or other specific property of the transferor.

We conclude that the principles that required the courts to announce the Kimbell-Diamond doctrine apply with full vigor to the admitted facts of this case.

The judgment is, therefore, affirmed.

RIVES, Chief Judge (dissenting).

The over-all plan was to acquire control of and continue the operation of the business enterprises owned and operated by the four closely connected corporations, and to capitalize upon their good will. Those corporations were to be liquidated, but the business enterprises were to remain the same under a new corporate form. That seems to me the type of situation which, both in substance and in form, calls for the application of Section 112(b) (6) rather than of the Kimbell-Diamond doctrine.

I therefore respectfully dissent.

APPENDIX D.

Notice.

The Tax Court of the United States.

Family Record Plan, Incorporated, (Dissolved), Petitioner, v. Commissioner of Internal Revenue, Respondent. Docket No. 75771.

Family Record Plan, Incorporated, Transferee of Family Record Plan, Incorporated, (Dissolved), Petitioner v. Commissioner of Internal Revenue, Respondent. Docket No. 57590.

Respondent, the Commissioner of Internal Revenue, moves that the portion of the Stipulation of Facts containing paragraphs 11 and 12 and the Stipulation of Errors in Official Report of Proceedings, which are annexed to this motion, be added to and be considered for all purposes as part of the record in the above-entitled cases.

The attached stipulations were executed by counsel for both parties early in June, 1960, and were transmitted to the office of the Chief Counsel for the Internal Revenue Service for filing, but through inadvertence apparently were not filed with the Tax Court at that time.

Wherefore, the Commissioner now respectfully prays that the annexed documents be added to the record in these cases and be transmitted to the United States

Court of Appeals for the Ninth Circuit as part of the record on review in these cases.

TAX COURT OF THE U. S.

GRANTED

DEC 20 1961

(Signed)
Russell E. Train
Judge

(Signed) CRANE C. HAUSER
CAR

Crane C. Hauser
Chief Counsel
Internal Revenue Service
Counsel for Respondent